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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 1021.

LEGH R. POWELL, JR. and HENRY W. ANDERSON, as Receivers of the Properties of Seaboard Air Line Railway Company,

Petitioners,

against

MARYLAND TRUST COMPANY, as Successor Trustee under the First Mortgage of Seaboard Air Line Railway dated April 14, 1900.

Respondent.

PETITION AND SUPPORTING BRIEF FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

W. R. C. COCKE,
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Attorneys for Petitioners,
Receivers of Seaboard Air
Line Railway Company.

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LEGH R. POWELL, JR. and HENRY W. ANDERSON, as Receivers of the Properties of Seaboard Air Line Railway Company,

Petitioners,

against

MARYLAND TRUST COMPANY, as Successor Trustee under the First Mortgage of Seaboard Air Line Railway dated April 14, 1900.

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Legh R. Powell, Jr. and Henry W. Anderson, as Receivers of the properties of Seaboard Air Line Railway Company, pray that a writ of certiorari issue to review the decree of the United States Circuit Court of Appeals for the Fourth Circuit, entered in the above

case on January 6, 1942 (R. 199),* modifying and affirming the decree of the District Court of the United States for the Eastern District of Virginia (R. 192).

JURISDICTION.

The decree of the Circuit Court of Appeals sought to be reviewed was entered on January 6, 1942. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 [C. 229, 43 Stat.; 28 U. S. C., Sec. 347(a).]

STATEMENT.

On or about September 28, 1901 Seaboard Air Line Railway, predecessor of Seaboard Air Line Railway Company, delivered to The Continental Trust Company, as Trustee under its First Mortgage, (Maryland Trust Company being now the successor Trustee), certificates for 4,450 shares of the capital stock of Richmond-Washington Company, a holding company controlled by stock ownership in equal proportions by the Seaboard and five other railroads. These shares were purchased with funds obtained by the Railway Company from the sale of Refunding Collateral Trust Bonds pursuant to a Trust Agreement, dated May 1, 1901, between the Railway Company and Central Trust Company of New York, as Trustee, and in accordance with that agreement the shares were delivered to The Continental Trust Company to be subjected

* The typewritten transcript of the entire record is on file with the Clerk of this Court. The parties have stipulated that for purposes of this petition only the joint appendix to the briefs of the parties in the court below and the proceedings below need be printed.

by pledge to the lien of the First Mortgage. The pertinent pledge provisions of this Mortgage are shown on pages 28 et seq. of the record,—and are quoted in the brief annexed hereto in support of this petition.

On October 31, 1930, the authorized capital stock of the Richmond-Washington Company was $3,000,000, divided into 30,000 shares having a par value of $100 per share. On that date there were issued and outstanding 26,700 shares of its capital stock, of which Seaboard Air Line Railway Company owned 4,450 shares, the same shares above referred to as pledged under the First Mortgage. The issued capital stock of the Richmond-Washington Company was increased on October 31, 1930, by the payment of a fifty per cent stock dividend, the payment of which had previously been approved by the directors and stockholders of the Company at duly called meetings. This dividend represented surplus derived wholly from profits and earnings of the Company. Immediately before the issuance of the stock dividend the book value of each of the original shares was $263.75, and immediately thereafter the book value of each of the old and the new shares was $175.83. As the 4,450 shares owned by the Railway Company, and held by the First Mortgage Trustee, were registered in the name of the Railway Company, the Railway Company prior to the Receivership received delivery of the fifty per cent stock dividend consisting of 2,225 shares. Upon receipt thereof the Railway Company continued to hold the certificates for the 2,225 shares, and upon the appointment of the Receivers of the Railway Company on December 23, 1930, the Receivers continued and still continue to hold the certificates for such shares in their possession.

Between their appointment on December 23, 1930 and December 30, 1931, inclusive, the Receivers were paid $53,400.00 in cash dividends upon the 4,450 shares pledged with the First Mortgage Trustee. In addition, the Receivers have received cash dividends of $114,031.25 from December 31, 1930 to date upon the stock dividend of 2,225 shares in the possession of the Receivers. These amounts include a cash dividend of $20,025.00 declared and payable to stockholders of record as of December 18, 1930, but not paid until December 31, 1930. Further dividends after 1931 on the 4,450 shares have been paid to the First Mortgage Trustee by the Richmond-Washington Company on demand of the Trustee,—the Receivers having conceded the validity of the pledge of the 4,450 shares and the right to the cash dividends thereon declared after demand by the Trustee that further dividends on the 4,450 shares be paid to it.

The Trustee of the First Mortgage made no claim whatever of a right to possession of the 2,225 shares until April 15, 1938, when a joint written demand by the Trustee of the First Mortgage and the Trustees of the Seaboard Air Line Railway Refunding Mortgage, who also claim a right to the 2,225 shares under the provisions of that mortgage, was served on the Receivers for delivery of the shares and payment over to the Trustee of the First Mortgage of the amounts of the dividends paid to the Receivers on both the 4,450 shares and on the 2,225 shares. The amounts of the dividends then aggregated $142,956.25, including $20,025.00 payable on December 31, 1930, to stockholders of record of the Richmond-Washington Company as of December 18, 1930.

On April 10, 1931, at a hearing upon the Receivers' application for authority to issue and presently sell $4,000,000 of Receivers' Certificates, there was introduced by the Receivers a statement of unpledged securities owned by Seaboard Air Line Railway Company as of December 23, 1930. This statement lists stocks of Richmond-Washington Company at a par value and book value of $222,500.00, and shows this stock as being 16⅔% of the stock of the Richmond-Washington Company owned by the Railway Company. This, of course, referred to the 2,225 stock dividend shares. The hearing on this application resulted in a decree, dated April 22, 1931, providing for a lien in favor of the Receivers' Certificates

> "(1) upon the surplus earnings and income hereafter coming into the hands of the Receivers, after paying out of such earnings and income, however derived, the expenses of the receivership and of operation, and such other amounts for similar purposes as the Court may direct, and upon any property or interest therein purchased with such surplus earnings and income; and
>
> "(2) upon all the property and assets of every nature and description of the Railway Company and/or the Receivers, whether real, personal or mixed, now or at any time hereafter in the possession or under the control of the Receivers (including, without limitation of the foregoing general description, securities, evidences of indebtedness, rolling stock, other equipment, and the interest of the Railway Company and/or the Receivers in equipment under equipment agreements).

prior to any lien thereon, direct or indirect, of the following general mortgages of the Railway Company, viz.:

> "First Mortgage, dated April 14, 1900, to The Continental Trust Company, Baltimore, Maryland, Trustee, and all supplements thereto;
>
> "Refunding Mortgage, dated October 1, 1909, to The New York Trust Company and Mortimer N. Buckner, as Trustees; * * *" (R. 125).

Thereafter, when the Receivers' Certificates issued under this decree were refunded pursuant to the provisions of a decree entered on February 15, 1933, which also authorized a large amount of additional certificates, and when the Receivers' Certificates issued under this latter decree were again refunded by decrees entered on March 20, 1935, authorizing the issuance of an aggregate of more than $23,000,000 of certificates, the identical provisions as to lien were embodied in these decrees and the statement showing unpledged securities was introduced and made a part of the record on the hearings preceding each of these later decrees. At all of these hearings the Trustee of the First Mortgage and the Trustees of the Refunding Mortgage were parties to the proceedings and were represented at the hearings by counsel, but asserted no rights to the 2,225 shares.

As the Receivers took the position that neither the Trustee of the First Mortgage, pursuant to the pledge provisions of the First Mortgage above referred to (R. 46), nor the Trustees of the Refunding Mortgage, were entitled to the possession of the 2,225 stock dividend shares or the cash dividends declared

thereon, and were not entitled to the pledge of cash dividends declared on the 4,450 shares pledged with the Trustee until demand was made therefor by the Trustee, and that the appointment of the Receivers constituted an equitable lien in favor of other creditors upon the stock and cash dividends collected by the Railway Company, and that the decrees of the District Court authorizing the issuance of Receivers' Certificates subjected to the lien of the certificates the stock and cash dividends collected by the Railway Company, the joint written demand by the Trustee of the First Mortgage and the Trustees of the Refunding Mortgage was refused.

Thereafter, on November 23, 1938, the Trustee of the First Mortgage and the Trustees of the Refunding Mortgage simultaneously filed petitions in the Consolidated Receivership Cause of Seaboard Air Line Railway, pending in the District Court of the United States for the Eastern District of Virginia, seeking possession and control of the stock and cash dividends collected by the Railway Company and by the Receivers after their appointment on December 23, 1930.

The controversy was referred by the District Court to a Special Master, who, in a report filed June 19, 1940 (R. 132), found for the First Mortgage Trustee, both as to the stock dividend and the total of the cash dividends claimed. This report was affirmed on June 28, 1941, by the District Court, except as to the cash dividend of $20,025.00 paid December 31, 1930, which was held to belong to the Receivers (R. 192). The Special Master held that the 2,225 shares had not been subjected to the lien of the Receivers' Certificates, giving as the reason that the record on the proceedings

for the issuance of the certificates failed to show that the Trustee of the First Mortgage was aware of an intention to subject the shares to the lien of the certificates and though represented in all the proceedings by counsel was not concluded by the language of the decrees, or by the evidence introduced by the Receivers showing that they claimed the 2,225 shares as a free asset of the Receivership Estate, which were to be subjected to the lien of the certificates. In confirming the Master's report the District Court paid no attention to the point (Memorandum Opinion, R. 185). The majority opinion of the Circuit Court of Appeals seems to have accepted the reasons given by the Master, but attaches little importance to the question. All parties appealed from the decree of the District Court, and on January 6, 1942, the court below, Soper, Circuit Judge, dissenting, affirmed this decree as modified by the adding of the amount of the dividend of December 31, 1930, $20,025.00, to the amount of the dividends which the Receivers were ordered to pay over and deliver to the First Mortgage Trustee (R. 169).

QUESTIONS PRESENTED.

1. The case involves the proper interpretation of a clause in the Seaboard Air Line Railway First Mortgage relating to the rights as between the railroad pledgor and the mortgage trustee as pledgee. It also involves questions as to the rights of the Trustees of Seaboard Air Line Railway Refunding Mortgage, who were appellants also in the court below. The parties, the District Court and the Circuit Court of Appeals all agree that the law to be applied in interpreting the pledge provisions of the First Mortgage is the law of

Maryland, which is the *forum contractus*, but Petitioner contends that neither the District Court nor the Circuit Court of Appeals applied the law of the State but on the contrary, ignored it and exercised an independent judgment as to what the law is, instead of following the decisions of the highest Court of the State.

2. Another question having an important bearing upon values of property and securities that must be considered in a reorganization of the Seaboard Air Line Railway is whether or not, irrespective of the question of interpretation of the mortgage, any inchoate rights of the trustees of the mortgages involved were subordinated to a paramount lien in favor of Receivers' Certificates issued pursuant to decrees of the Courts of jurisdiction of the Seaboard Air Line Railway Receivership and found to be necessary for the proper maintenance and operation of the railway properties in the interest of the public and of the security holders of the railway.

STATUTE INVOLVED.

Section 34 of the Federal Judiciary Act of September 24, 1789 (1 Stat. at L. 92), chap. 20, 28 U. S. C. A., Sec. 725, provides as follows:

> "The laws of the several States, except where the Constitution, treaties, or statutes of the United States otherwise require or provide, shall be regarded as rules of decision in trials at common law, in the courts of the United States, in cases where they apply."

SPECIFIC ASSIGNMENTS OF ERROR TO BE URGED.

The court below erred:

1. In holding the Trustee of the First Mortgage to be entitled to a lien upon and the possession of the 2,225 shares of Richmond-Washington Company declared as a stock dividend upon the 4,450 shares of the stock of said Company owned by Seaboard Air Line Railway Company and held in pledge by the Trustee under the First Mortgage.

2. In holding the Trustee of the First Mortgage to be entitled to a lien upon and the possession of $53,400.00, representing cash dividends paid from December 31, 1930 to December 31, 1931 upon the 4,450 shares of stock held by the Trustee in pledge under the First Mortgage, and $114,031.25, representing cash dividends paid the Receivers from December 31, 1930 to date by Richmond-Washington Company upon the 2,225 stock dividend shares held by the Receivers.

3. In holding that the lien of the First Mortgage was not subordinated to the liens of the Receivers' Certificates under the decrees of the Courts administering the Receivership.

REASONS FOR GRANTING THE WRIT.

This case comes within the provisions of Paragraph 5(b) of Rule 38 of this Court.

1. The Circuit Court of Appeals for the Fourth Circuit has here erroneously failed to apply the ap-

plicable Maryland law with respect to the nature of a stock dividend upon shares of capital stock of a corporation, a question of public importance concerning the interrelation of State and Federal Courts, and has rendered a decision in conflict with the decisions of this Court.

This Court in the cases of *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, 82 L. Ed. 1188; *Ruhlin* v. *New York L. Ins. Co.*, 304 U. S. 202, 82 L. Ed. 1290; *West* v. *American Teleph. & Teleg. Co.*, 311 U. S. 223, 85 L. Ed. 139, and others, has declared that except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State.

Although the Maryland common law with respect to the nature of a stock dividend was firmly established by a long line of decisions of the Court of Appeals of Maryland, beginning with *Thomas* v. *Gregg*, 78 Md. 545, 28 Atl. 565, and summed up in *Heyn* v. *Fidelity Trust Co.*, 174 Md. 639, 1 Atl. (2d) 83, when the pledge under consideration in this case was made, the majority of the court below concluded that it was free to exercise an independent judgment as to what the law is, and arrived at its conclusion by resort to contrary decisions of the courts of Missouri, Virginia, North Carolina and the United States.

2. The Circuit Court of Appeals, as did the District Court, ignored the decrees directing the issuance of the Receivers' Certificates and providing for a lien security for such certificates, upon which decrees the holders of such certificates, for whom the Receivers are in a sense trustees, had a right to rely and in view of

the record in those proceedings assume that the lien of the certificates covered the 2,225 shares of stock. The facts in greater detail are shown in the brief annexed hereto in support of this petition.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari should be granted.

March 5, 1942.

W. R. C. Cocke,
Harold J. Gallagher,
Geo. V. Credle, Jr.,
For Petitioners.

IN THE

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Petitioners,

against

MARYLAND TRUST COMPANY, as Successor Trustee under the First Mortgage of Seaboard Air Line Railway dated April 14, 1900.

Respondent.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

OPINIONS OF THE COURTS BELOW.

The report of the Special Master to whom this case was referred by the District Court will be found beginning at page 132 of the Record. The decree of the District Court will be found beginning at page 192 of the Record, and its memorandum at page 185. The opinion of the Circuit Court of Appeals (R. 194) has not yet been reported.

JURISDICTION.

As stated in the petition, the decree of the Circuit Court of Appeals to be reviewed was entered January 6, 1942 (R. 199). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, chap. 229, 43 Stat. 938; 28 U. S. C. A., Sec. 347(a).

STATEMENT OF THE FACTS.

The facts are not in dispute. They have been agreed upon in a stipulation and a supplement thereto, signed by counsel for all parties to the appeals below (R. 1, 131). The material facts will be briefly summarized in order that the contentions of the parties may be better understood.

On or about September 28, 1901 the Railway Company delivered to The Continental Trust Company, as Trustee under the First Mortgage (Maryland Trust Company being now the successor Trustee), certificates for 4,450 shares of the capital stock of Richmond-Washington Company. These shares were purchased with funds obtained by the Railway Company from the sale of Refunding Collateral Trust Bonds pursuant to a Trust Agreement, dated May 1, 1901, between the Railway Company and Central Trust Company of New York, as Trustee, and in accordance with that agreement the shares were delivered to The Continental Trust Company to be subjected to the lien of the First Mortgage. The pertinent pledge provisions of this Mortgage are shown on pages 6, et seq., *infra*, of this brief.

Subsequently, the Railway Company executed and delivered to The New York Trust Company and Mortimer N. Buckner, as Trustees, its Refunding Mortgage, dated October 1, 1909. The granting clauses of that Mortgage specifically refer to Richmond-Washington Company stock. Sub-clause (b) of Clause Third of the granting clauses in part provides:

> "(b) The following bonds and shares of stock subject to the lien of the Seaboard First Mortgage, and to the lien of the Three-Year Mortgage, and now in possession of The Continental Trust Company, Baltimore, Maryland, Trustee of the Seaboard First Mortgage:
>
> "1. 4,450 shares of the capital stock of Richmond-Washington Company;"

Sub-clause (g) of that clause, among other things, provides:

> "(g) All shares of stock of any of the companies shares of stock whereof are pledged or agreed to be pledged hereunder in the foregoing sub-clauses (a), (b), (d) and (e), which the Railway Company now owns or shall hereafter acquire; * * *"

Also, under Section 2 of ARTICLE THREE of that Mortgage the Railway Company covenanted to deliver, or cause to be delivered, such stock immediately upon the acquisition thereof.

The Richmond-Washington Company is a New Jersey corporation, whose certificate of incorporation was filed September 5, 1901. It is a holding company and controls $955,000 out of $1,316,900 par value

voting common stock and all of the non-voting common stock of the Richmond, Fredericksburg & Potomac Railroad Company. On October 31, 1930, and prior thereto, the capital stock of the Richmond-Washington Company was owned in equal parts, and continues so to be owned, by the Pennsylvania Railroad Company, the Baltimore & Ohio Railroad Company, the Atlantic Coast Line Railroad Company, the Southern Railway Company, the Seaboard Air Line Railway Company, and the Chesapeake and Ohio Railway Company. On that date the authorized capital stock of the Richmond-Washington Company was $3,000,000, divided into 30,000 shares having a par value of $100 per share. Also on that date there were issued and outstanding 26,700 shares of its capital stock, of which Seaboard Air Line Railway owned 4,450 shares, the same shares above referred to as pledged under the First Mortgage. The issued capital stock of the Richmond-Washington Company was increased on October 31, 1930 by the payment of a fifty per cent stock dividend, the payment of which had previously been approved by the directors and stockholders of the company at duly called meetings. This dividend represented a capitalization of surplus derived wholly from profits and earnings of the Company. As the 4,450 shares owned by the Railway Company, and held by the First Mortgage Trustee, were registered in the name of the Railway Company, the Railway Company prior to the Receivership received delivery of the fifty per cent stock dividend consisting of 2,225 shares. Upon receipt thereof the Railway Company continued to hold the certificates for the 2,225 shares, and upon the appointment of the Receivers of the Railway Company on December 23, 1930, the Receivers continued

and still continue to hold the certificates for such shares in their possession.

Between their appointment on December 23, 1930, and the submission of the case to a Special Master by the District Court the Receivers had been paid $53,400.00 in cash dividends upon the 4,450 shares held by the First Mortgage Trustee. These dividends were received from December 31, 1930 to December 30, 1931, inclusive. In addition, the Receivers have received cash dividends of $114,031.25 from December 31, 1930 to date upon the stock dividend of 2,225 shares in the possession of the Receivers. Further dividends after 1931 on the 4,450 shares have been paid to the First Mortgage Trustee by the Richmond-Washington Company on demand of the Trustee,—the Receivers having conceded the validity of the pledge of the 4,450 shares and the right to the cash dividends thereon declared after demand by the Trustee that further dividends on the 4,450 shares be paid to it. When this demand was made the First Mortgage Trustee neither demanded payment to it of the dividends collected by the Receivers nor delivery to it of the 2,225 shares.

As will be fully explained hereafter the stock dividend of 2,225 shares was declared and a certificate for this stock delivered to the Railway Company nearly two months prior to the appointment of the Receivers and at a time long prior to any event of default under the provisions of the First Mortgage. The First Mortgage was executed in 1901 by Seaboard Air Line Railway, the predecessor of Seaboard Air Line Railway Company, which came into existence in 1915 by certain merger and consolidation proceedings described in

detail in the stipulation of facts, and which thereafter assumed the obligations of the First Mortgage. The Mortgage was the financing medium under which bonds were issued and sold in connection with the acquisition of the stocks and certain other securities of some fifteen separate companies, the properties of which include those now subject as a first lien to the so-called Underlying Divisional Mortgages. The stocks of these constituent companies were pledged under the Mortgage, ARTICLE THREE of which, in eight separate sections, contains elaborate provisions for the protection of the rights of the trustee in the continued control through the pledge of these securities over the properties of the constituent companies. These provisions, sometimes referred to as "Dilution Clauses," are intended to prevent the Railway Company from acquiring through any device securities of the constituent companies other than those pledged under the mortgage in such a way as to impair the value of the security represented by the properties of the constituent companies and their pledged securities. Accordingly, these provisions of the mortgage require the pledge with the Mortgage Trustee of any additional stocks or other securities of these companies at any time thereafter acquired by the mortgagor, Seaboard Air Line Railway.

On the contrary the stock of Richmond-Washington Company is nowhere mentioned in the mortgage and the pledge of the 4,450 shares originally acquired by the Seaboard is nowhere specifically provided for. The pledge of this stock, conceded by all the parties as a valid one, was effected merely by delivery and without any formal instrument evidencing either de-

livery or pledge pursuant to Clause IV of the Granting Clauses,—a catch-all provision, which reads as follows:

> "Any and all other property of any kind, including stocks, bonds, claims or indebtedness, which from time to time hereafter may be conveyed and mortgaged or pledged and delivered or by writing of any kind assigned or transferred by the 'Railroad Company,' or by anyone in its behalf, to the 'Trustee,' which is hereby authorized at any and all times to receive any property as and for additional security, and also when and as hereinafter provided as substituted security for the bonds issued or to be issued hereunder, and to hold and apply any and all such property subject to the terms hereof."

The 4,450 shares were not paid for from the proceeds of any of the First Mortgage Bonds. On the contrary, as Section 18 of the stipulation shows (R. 16), these shares were acquired with the proceeds from the sale of $445,000 of Collateral Trust Bonds, which have since been paid off and retired. The retirement of the Collateral Trust Bonds was accomplished ultimately through the sale of Refunding Mortgage Bonds issued under the Refunding Mortgage of Seaboard Air Line Railway and it was doubtless in this connection that the Refunding Mortgage which is hereinafter more fully referred to provided specifically for the pledge of any subsequently acquired shares of stock of Richmond-Washington Company. Other pertinent provisions of the First Mortgage are as follows:

Section 2 of ARTICLE TWO, which contains the

covenants of the Railway Company, provides the customary covenant that the Railway Company will execute any other necessary instruments to protect the security and accomplish the purposes of the mortgage, but expressly disclaims any intention to "limit the right or power of the 'Railroad Company' * * * to own and hold, or to construct, or to acquire, other lines of railroad, or branches or extensions, or interests therein, *or other property*, free from the lien hereof." (Italics supplied.)

Section 8 of the covenants, which again is referable to the dilution clauses and to the securities of the constituent or underlying companies, provides:

> "Except subject to the lien hereof, or as herein otherwise expressly provided, the 'Railroad Company' (1) will not sell, encumber, or by any voluntary act part with its ownership of or title to any shares of stock of any company which shall have been pledged or assigned hereunder (if a majority of the shares of such company shall have been so pledged or assigned), or its equity of redemption therein, or the voting power thereon; and (2) will, subject to the lien hereof, hold all and singular such stock of every company of whose capital stock the greater part shall have been pledged or assigned hereunder, and will exercise its voting power thereon in such manner that it shall retain in itself the rights and powers of the holder of the greater part of the capital stock of such company; and (3) will at all times take all such action as from time to time may be necessary to preserve the corporate existence and corporate rights of every company of whose capital stock the greater part shall be pledged or assigned hereunder.

"As such holder of such stock it will not, by affirmative vote or by abstaining from voting, sanction or permit any increase of the capital stock of any such company, or the creation of any indebtedness of any such company (except current operating accounts for a period not at any time exceeding six months prior thereto), or the issue or guaranty of any bonds by such company, or the creation of any mortgage or other lien upon the railroad or property of any such company, unless effective provision be made that such indebtedness and the evidence thereof, and such bonds issued or guaranteed and such mortgage or other lien and all such additional stock (or such part of such additional stock as is proportionate to the part of such capital stock previously pledged or assigned hereunder), shall immediately, upon the issue or creation thereof, be delivered to and pledged with or assigned to the 'Trustee,' by it to be held subject to all the trust of this indenture, with the same effect as if all such indebtedness, bonds, mortgages or other liens or shares, as the case may be, had been delivered and pledged or assigned to it hereunder at the time of the making hereof, and all such additional stock shall be fully paid and non-assessable.

"Except as herein otherwise expressly provided, the 'Railroad Company' will not, by affirmative vote, or by abstaining from voting, sanction or permit any company, of whose capital stock the greater part shall be pledged or assigned hereunder, to sell or otherwise to dispose of its railroad, or to lease the same (unless such lease be terminable hereunder by entry of the 'Trustee' or by sale by the 'Trustee,' or pursuant to judicial proceedings), except to the 'Railroad Company,' or to some other company of whose capital stock there

> shall then be held by the 'Railroad Company,' or be pledged or assigned to the 'Trustee' hereunder, at least ninety-five per cent thereof, or a percentage not less than the percentage held hereunder of the capital stock of the company whose railroad shall be so sold or otherwise disposed of or leased, if such percentage of such last-named capital stock shall be less than ninety-five per cent of the entire amount thereof."

Section 1 of ARTICLE THREE, which deals with the "BONDS AND STOCKS PLEDGED HEREUNDER," expressly provides that unless and until the mortgagor Railroad Company shall be in default as the several defaults are specifically defined in the section:

> "The 'Trustee' (except with the assent of the 'Railroad Company') shall not collect or be entitled to collect the interest of any of the bonds or claims or indebtedness now or hereafter pledged with or assigned to the 'Trustee' under this indenture; *and the 'Railroad Company' shall be entitled to receive all interest paid or dividends declared in respect of any bonds or stocks transferred to or pledged with the 'Trustee' pursuant to any of the provisions of this indenture,* * * *. *In every such case the 'Railroad Company' shall be entitled for its own use to demand and receive and collect, release and discharge the principal or interest of any such claim against or indebtedness (other than bonds) of any other company pledged with the 'Trustee' hereunder; and upon the request of the 'Railroad Company' the 'Trustee' shall execute any reassignments or releases which may be required for that purpose.*" (Italics supplied.)

Section 3 of this article further provides that unless the Railroad Company shall be in default and such default shall have continued beyond the six months' period of grace previously defined, or unless the Trustee shall have entered into possession of the mortgaged properties, the Railroad Company

> "shall have the right to vote upon all shares of stock pledged hereunder, for all purposes not inconsistent with the provisions or purposes of this indenture, and with the same force and effect as though such pledge had not been made."

It was pursuant to these various provisions, clearly, as we contend, entitling it to do so, that the Seaboard voted the 4,450 shares of stock in favor of the stock dividend (R. 11) and continued to receive dividends not only on the 2,225 shares but also on the 4,450 shares until after default had occurred under the provisions of the mortgage. The facts with reference to the declaration of the stock dividend are shown in Sections 8 to 16, inclusive, of the stipulation (R. 9 et seq.), which are as follows:

> "8. R-W Co. is a New Jersey corporation whose certificate of incorporation was filed September 5, 1901. A copy of its certificate of incorporation is Exhibit 11 of this stipulation. It is a holding company and controls $955,000 out of $1,316,900 par value voting Common Stock and all of the non-voting Common Stock of Richmond, Fredericksburg & Potomac Railroad Company. Said latter railroad company owns and operates a line of railway between Washington, D. C. and Richmond, Virginia, and other transportation properties.

"9. On October 31, 1930, and prior thereto, the capital stock of R-W Co. was owned in equal parts, and continues so to be owned in equal parts, by six railroad companies, namely: Pennsylvania Railroad Company, Baltimore & Ohio Railroad Company, Atlantic Coast Line Railroad Company, Southern Railway Company, Seaboard Air Line Railway Company and Chesapeake & Ohio Railway Company. A copy of a balance sheet of R-W Co. as of December 31, 1901, is Exhibit 12 of this stipulation. On said date the authorized capital stock of R-W Co. was $3,000,000, divided into 30,000 shares having par value of $100 per share. Also on said date there were issued and outstanding 26,700 shares of its capital stock, of which Seaboard No. 2 owned 4,450 shares which were pledged as aforesaid under the First Mortgage.

"10. On September 18, 1930, the board of directors of R-W Co. adopted a resolution declaring a dividend of 50% on the capital stock, payable in stock on and after October 31, 1930, subject to approval by the stockholders of an increase in the authorized capital stock of the company from $3,000,000 to $5,000,000 and the filing of an appropriate amendment of the charter to evidence such increase. A copy of the board resolution is Exhibit 13 of this stipulation. Prior to the board meeting A. J. County, Vice-President of R-W Co., sent to each member of the board a letter dated March 12, 1930, a copy of which is included in Exhibit 14 of this stipulation. Included in said exhibit are also copies of correspondence as follows:

> "Letter dated June 28, 1932, from T. W. Mathews, Secretary of Seaboard Air Line Railway Company to J. Taney Willcox, Secretary of Richmond-Washington Company;

"Reply letter dated July 15, 1932, to Mathews from A. J. County, President of Richmond-Washington Company;

"Letter dated August 2, 1932, from Mathews, signed as Treasurer for Receivers, to County;

"Letter dated August 3, 1932, from County to Mathews.

"11. On October 10, 1930, the stockholders of R-W Co. adopted a resolution authorizing the increase of the authorized capital stock from $3,000,000 to $5,000,000 and approving the issuance and disposition of such increase in whole or in part by stock dividend, or by sale or otherwise, at a price or prices not less than par, at such time or times, in such manner, and upon such terms as should be by the board of directors declared and prescribed. A copy of such resolution is Exhibit 15 of this stipulation. A copy of the amendment to the charter filed in accordance with such resolutions of the board and of the stockholders is Exhibit 15A of this stipulation.

"12. On October 31, 1930, pursuant to said action of the board and the stockholders of R-W Co., a 50% stock dividend was paid by said Company to its stockholders, as a result of which certificates evidencing 2,225 shares were delivered to defendant Railway Company on said date in respect of 4,450 shares theretofore held by it and pledged under the First Mortgage as aforesaid. Upon receipt thereof defendant Railway Company continued to hold certificates for said 2,225 shares, and upon appointment of Receivers of defendant Railway Company such Receivers continued and still

continue to hold certificates for such shares in their possession.

"13. From 1901 to 1930, both dates inclusive, R-W Co. paid dividends on its capital stock as follows:

Year	Dividend Per Share Per Annum
1901	None
1902	$3.00
1903-5	4.00
1906-7	None
1908-15	4.00
1916	5.00
1917-22	6.00
1923	7.00
1924-25	8.00
1926-28	10.00
1929	10.50
1930	16.50 and stock dividend of 50%

"14. The balance sheets of R-W Co., as at December 31, 1929, and December 31, 1930, are, respectively, Exhibits 17 and 18 of this stipulation. Immediately prior to the issuance of such stock dividend the book value of each of the 26,700 shares of capital stock then outstanding was $263.75, and immediately after the issuance the book value of each of the 40,000 shares then outstanding was $175.83.

"15. On or about September 28, 1901 (the date of the delivery of 4,450 shares by Seaboard No. 1 under the First Mortgage), R-W Co. had no substantial accumulated net earnings. On or about September 28, 1901, the date of the delivery of 4,450 shares of R-W Co. stock under the First Mortgage, the book value of each of such shares was approximately $100.00. The said stock dividend was paid out of and charged against the profit and loss account of R-W Co.

"16. From and after December 23, 1930 (the date of appointment of Receivers herein), the Receivers have received and retained cash dividends on R-W Co. stock as follows:

Rate Per Share	Date Payable	Date Received	Amount
$3.00*	December 31, 1930*	December 31, 1930*	$ 20,025.00*
2.25	March 31, 1931	March 31, 1931	15,018.75
2.25	June 30, 1931	July 1, 1931	14,996.25
		July 15, 1931	22.50
2.25	September 30, 1931	October 3, 1931	15,018.75
2.25	December 30, 1931	January 4, 1932	15,018.75
2.25	March 31, 1932	April 4, 1932	5,006.25
1.00	June 30, 1932	July 19, 1932	2,225.00
1.00	March 1, 1933	March 1, 1933	2,225.00
2.00	June 30, 1933	July 5, 1933	4,450.00
2.00	December 30, 1933	January 2, 1934	4,450.00
4.00	March 31, 1934	April 2, 1934	8,900.00
4.00	March 30, 1935	April 2, 1935	8,900.00
4.00	March 31, 1936	March 31, 1936	8,900.00
1.00	December 15, 1936	December 16, 1936	2,225.00
1.00	December 26, 1936	January 8, 1937	2,225.00
6.00	December 22, 1937	December 27, 1937	13,350.00
			$142,956.25

*Payable to stockholders of record as of December 18, 1930, pursuant to action of board of directors of R-W Co. prior to that date.

"Of the above dividends, those received by the Receivers from December 31, 1930, to January 4, 1932, (both dates inclusive), were paid in respect of 6,675 shares of R-W Co. and from April 4, 1932, to the present time in respect of 2,225 shares; after January 4, 1932, cash dividends paid in respect of 4,450 shares were received and retained by the Trustee of the First Mortgage and cash dividends in respect of 2,225 shares have been received and retained by the Receivers." (From December 27, 1937 to date there have been received by the Receivers cash dividends upon the 2,225 shares amounting to $11,125.)

The Trustee of the First Mortgage made no

claim whatever of a right to possession of the 2,225 shares until *April 15, 1938* (R. 26), when a joint written demand by the Trustee of the First Mortgage and the Trustees of the Refunding Mortgage was served on the Receivers for delivery of the shares and payment over to the Trustee of the First Mortgage of the amounts of the dividends paid to the Receivers on both the 4,450 shares and on the 2,225 shares. The amounts of the dividends then aggregated $142,956.25, including $20,025.00 payable on December 31, 1930, to stockholders of record of the Richmond-Washington Company as of December 18, 1930.

That the Trustee of the First Mortgage, however, had been made plainly aware as early as April, 1932, that the stock dividend had been declared and that the shares were in the possession of the Receivers is conclusively shown by two letters (R. 83-84) passing between T. W. Mathews, Secretary of the Seaboard, and J. A. Wherrett, Secretary of The Continental Trust Company, the Trustee of the First Mortgage. For on March 11, 1932, Mr. Wherrett wrote Mr. Mathews as follows:

> "We only today received your letter of February 17th advising us the dates in 1931 on which dividends were paid on the capital stock of the Richmond-Washington Company.
>
> "Will you please advise us promptly as possible the dates and amounts of any stock dividends declared on the capital stock of Richmond-Washington Company since 1901 and also the dates and amounts of cash dividends paid on such shares after April 1, 1931, the date on which default occurred under the First

Mortgage from your Company to The Continental Trust Company as Trustee, dated April 14, 1900.

"You will note that this letter is signed by The Continental Trust Company, whose corporate existence as a fiduciary is being maintained solely for legal reasons, its business having been merged with the Maryland Trust Company."

to which Mr. Mathews replied on April 5, 1932:

"Replying to your letter of the 11th ultimo with respect to dividends paid on the capital stock of the Richmond-Washington Company.

"In 1930 a stock dividend of 50% was declared payable to stockholders of record at the close of business on October 21, 1930. This dividend amounted to 2,225 shares.

"The dates and amounts of cash dividends paid on the capital stock after April 1, 1931, are as follows:

Date	On 4,450 Shares	On 2,225 Shares	Total
June 30, 1931.....	$10,012.50	$ 5,006.25	$15,018.75
Sept. 30, 1931.....	10,012.50	5,006.25	15,018.75
Dec. 31, 1931.....	10,012.50	5,006.25	15,018.75"

This, however, was not the only or earliest notice to the Trustee of the First Mortgage of the fact of the existence and possession of these shares by the Receivers and their claim of dominion thereover. For as shown by Section 17 of the stipulation (R. 13), counsel for Trustee were duly served on June 9, 1931, with copies of Receivers' Application No. 28, Section VII of which dealing with the sale and transfer to William H. Coverdale of one share of stock to qualify

him to represent the Seaboard as a director on the board of the Richmond-Washington Company, expressly recites that the defendant Railway Company is the owner of 6,675 shares of the capital stock of Richmond-Washington Company and that "4,450 shares of such stock * * * are pledged under the Seaboard Air Line Railway First Mortgage and 2,225 shares * * * are held unpledged in the treasury of the Receivership Estate."

On April 4, 1931, the Receivers filed their Application No. 19 for authority to issue and presently sell $4,000,000 of Receivers' Certificates. This application was referred to James E. Heath, Esq., as Special Master, who held a hearing on April 10, 1931 (R. 117). Among the exhibits introduced at the hearing was Exhibit No. 7 listing in connection with the testimony of R. P. Jones, the Receivers' Chief Finance and Accounting Officer, a statement of *unpledged securities* owned by Seaboard Air Line Railway Company as of December 23, 1930. This exhibit, which is No. 26 to the stipulation (R. 114) lists stocks of Richmond-Washington Company at a par value and book value of $222,500.00, and shows this stock as being 16⅔% of the stock of the Richmond-Washington Company owned by the Seaboard. The Trustee of the First Mortgage and the Trustees of the Refunding Mortgage were parties to the proceeding on Application No. 19 and were represented at the hearing by counsel. In identifying this exhibit Mr. Jones testified:

> "Q. Have you a list of what we refer to as the free assets of the Seaboard Air Line Railway Company that were in existence on

the day of the Receivership and came into the hands of the Receivers?

"A. Yes, sir. I have two statements. The first is a statement of unpledged securities owned as of December 23, 1930, exclusive of the Company's own issues.

"Q. Now when you say 'free assets' those were the stocks and bonds and notes not pledged under any of the mortgages or other instruments of the Seaboard Air Line Railway Company?

"A. That is correct." (R. 111).

The hearing on Application No. 19 resulted in a decree (Order No. 19A), dated April 22, 1931, providing for a lien in favor of the Receivers' Certificates upon

> "All the property and assets of every nature and description of the Railway Company and of the Receivers, whether real, personal or mixed, now or at any time hereafter, prior to the termination of the Receivership, in the possession or under the control of the Receivers (including without limitation of the foregoing general description, securities, equipment obligations, evidence of indebtedness * * *." (R. 125).

Thereafter, when the Receivers' Certificates issued under Order No. 19A were refunded pursuant to the provisions of Order No. 63, entered on February 15, 1933, and when the Receivers' Certificates issued under the latter order were again refunded by Orders Nos. 160A and 160B, entered on March 20, 1935, the identical provisions as to lien were embodied in these de-

crees and the exhibit showing the unpledged securities introduced by the witness R. P. Jones was made a part of the record on the hearings of each of these later applications. At both these later hearings the Trustees of both the First Mortgage and of the Refunding Mortgage were represented by counsel.

In view of these proceedings it is clear that the Receivers throughout the three proceedings involving the issuance of Receivers' Certificates had treated the 2,225 shares as assets of the Receivership Estate available for subjection to the lien of the Receivers' Certificates.

As we shall point out hereafter, the question of the right of the Court under the decrees to subject the stock to the lien of the certificates involves much broader considerations than any mere question of estoppel of the Trustees of either the First Mortgage or of the Refunding Mortgage arising from its silence, its failure to interpose objections during the course of the proceedings and its failure even to make demand for the 2,225 shares or cash for eight years after the Receivership had begun. The certificates of stock were in the actual physical possession of the Receivers and as we shall undertake to show, were clearly within the scope of the Court's power in connection with the decrees authorizing the issuance of the Receivers' Certificates, irrespective, even of any claims or liens in favor of the Trustee of the First Mortgage, or the Trustees of the Refunding Mortgage.

ARGUMENT.

As indicated in the preceding petition, it is contended that the court below, in addition to its failure to apply the applicable State law with respect to the nature of a stock dividend and the rights as between pledgor and pledgee erroneously held the Trustee of the First Mortgage to be entitled to a lien upon and the possession of the 2,225 stock dividend shares, the cash dividends declared thereon and the cash dividends declared upon the 4,450 shares owned by the Railway Company and pledged with the Trustee of the First Mortgage, collected by the Railway Company prior to any demand for the pledge thereof by the Trustee of the First Mortgage—and this despite the pledge provisions of the First Mortgage, the appointment of the Receivers, and the subjection of both the stock and cash dividends to the lien of the Receivers' Certificates authorized by decrees of the District Court.

It is not disputed that if the 2,225 shares are properly within the category of dividends, as that term is used in Section 1 of ARTICLE THREE of the Mortgage, the Railway Company had the full right to them at all times prior to an event of default. And it is also undisputed that no event of default under the First Mortgage had occurred until after the Receivership and therefore after the 2,225 shares had been delivered to the Railway Company. The District Court in its memorandum in support of its decree (R. 185) and the Special Master in his report (R. 132) both recognized that the right of a pledgee to receive dividends declared upon shares of stock held in pledge is an incident to the pledgee's special ownership only *in the absence of an agreement to the contrary.*

The majority of the Circuit Court of Appeals concluded that the 2,225 shares were not a dividend in any true sense, but a distribution of capital assets. This conclusion was reached by completely ignoring the applicable Maryland law, as is clearly pointed out in the dissenting opinion of Judge Soper.

I.

The Circuit Court of Appeals for the Fourth Circuit Has Rendered a Decision in Conflict With Section 34 of the Federal Judiciary Act and the Decisions Of This Court.

This Court has declared that the proper construction of Section 34 of the Federal Judiciary Act (28 U. S. C. A., Sec. 725) requires that Federal Courts in all cases, except in matters governed by the Federal Constitution or by Acts of Congress, apply the entire body of substantive law governing identical actions in the State courts. *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, 82 L. Ed. 1188; *Ruhlin* v. *New York L. Ins. Co.*, 304 U. S. 202, 82 L. Ed. 1290. It has prescribed the duty of the Federal Courts in every such case to be "to ascertain from all the available data what the State law is and apply it rather than to prescribe a different rule, however superior it may appear from the viewpoint of 'general law' and however much the State rule may have departed from prior decisions of the Federal Courts." *West* v. *American Teleph. & Teleg. Co.*, 311 U. S. 223, 85 L. Ed. 139; *Fidelity Union Trust Co.* v. *Field*, 311 U. S. 169, 85 L. Ed. 109; *Stoner* v. *New York Life Ins. Co.*, 311 U. S. 464, 85 L. Ed. 284.

The majority opinion of Judge Parker apparently

concedes that under the Maryland law if this had been a question as between life tenant and remainderman rather than between pledgor and pledgee, the Railway Company would have been entitled to the 2,225 shares. After citing Federal and State Court cases holding that stock dividends are not really dividends and that it would violate that doctrine to hold the 2,225 shares to be dividends even though they were declared based upon surplus earnings which could have been as well distributed in cash as in stock, the majority opinion says:

> "The only argument against this position is based upon certain Maryland decisions, beginning with *Thomas* v. *Gregg*, (1894) 78 Md. 545, 28 Atl. 565, to the effect that under a trust giving the income of property to a person for life with provision that the principal be paid to others upon his death, dividends, whether in stock or in cash, to the extent that they represent profits arising subsequent to the creation of the trust, will be distributed to the life tenant as income of the trust estate. We note in passing that the rule of these decisions has been changed by statute in Maryland, as it has in New York. See Flack's Annotated Code of Maryland, art. 75B, sec. 5. The rule, however, does not solve our problem; for the question with which it deals is, not the nature of dividends and what is to be included within the terms, but the nature of corporate income and how it should be apportioned between life tenant and remainderman under a trust, the rule being applicable to true dividends paid in cash as well as to stock dividends representing capitalization of corporate surplus. No such question is presented here.

> There is no reservation of income to the Seaboard. Only dividends are reserved; and, as to these, there is no question as to who is entitled to them, once they are found to be dividends within the meaning of the reservation. Upon this question the rule as to apportionment of income of corporate stocks between life tenant and remainderman manifestly cannot be determinative; for that rule, as applied to stock dividends, does not mean that stock dividends are to be treated in all respects as cash dividends, but merely that, when corporate income is capitalized and stock certificates are issued evidencing the capitalization, a life tenant entitled to the income of the trust property is entitled to the certificates. Since it is not income but dividends which is reserved to the Seaboard, our problem is to decide, not what is properly included in income, but what is properly included in 'dividends,' * * *."

This not only ignores the Maryland law but also ignores the provisions of the First Mortgage heretofore quoted, which clearly showed that the Railway Company, as long as it was not in default should be entitled to the income and increment of pledged securities, although referred to in the mortgage as dividends or interest, as the case might be, on pledged securities. The falacy of the reasoning of the majority is completely exposed by the dissenting opinion. As well said by Judge Soper:

> "We are obliged in the pending case to search for and apply the Maryland law in the interpretation of a trust indenture from a railroad company to a trustee to secure an issue of mortgage bonds, and to construe a clause of

the contract that is without precise precedent in judicial decision in Maryland or elsewhere, so far as search of the authorities has disclosed. Certain bonds and stocks were pledged with the trustee by the Railroad Company as security for the mortgage debt, including 4,450 shares of the Richmond-Washington Company, one-sixth of the outstanding stock of a holding company which owned the Richmond, Fredericksburg and Potomac Railroad. As to these securities the mortgage provided in effect in Article 3, Section 1, that unless the Railroad Company should be in default in the payment of some interest upon its bonds for a period of six months, the trustee should not be entitled to collect the interest of any of the bonds or claims or indebtedness pledged with the trustee, and the Railroad Company should be entitled to receive all interest paid or dividends declared in respect of any bonds or stocks so pledged. Article 9 of the mortgage provided that until some default, the Railroad Company should be permitted to retain actual possession of the mortgaged premises and manage and operate and use the same, and collect and receive the earnings, income, rents and profits thereof. It is plain from these provisions of the contract and from the continued operation of the mortgaged property by the mortgagor, that the Railroad Company was expected to hold and operate the railroad and to enjoy the income from its operation and its investments until default, while the trustee was to hold the tangible property and securities described in the mortgage as a pledge to ensure the payment of the mortgage debt.

"It was under these circumstances and before any default on the part of the Railroad Company had occurred, that the Richmond-

Washington Company declared a stock dividend of 50 per cent, which amounted to 2,225 shares on the holdings of the Railroad Company, and was delivered to it. The dividend was based on earnings which had accrued subsequent to the delivery of the stock in pledge to the trustee named in the mortgage. Now that the Railroad Company is in the hands of receivers, the question has arisen as to whether this dividend belongs to the trustee under the mortgage, as the representative of the bondholders, or to the receivers of the Railroad Company subject to the claims of other secured or general creditors.

"We are not aided in answering this question by the general rule in Maryland and elsewhere that a dividend accruing upon pledged stock belongs to the pledgee; for a contrary provision has been made in the terms of the contract. We must determine whether under the Maryland law the provision of the contract, that the Railroad Company until default is entitled to dividends on the pledged stock, covers the stock dividend in this case. We are told that the stock dividend does not fall within the terms of the contract because a stock dividend is not a true dividend. The leading authorities cited for the rule in the opinion of the Court in the pending case are the well known decisions of *Gibbons* v. *Mahon*, 136 U. S. 549, and *Eisner* v. *Macomber*, 252 U. S. 189. These decisions are based upon the logical theory that a stock dividend really takes nothing from the property of the corporation and adds nothing to the interest of the stockholders; that it is not a realization of profits by the stockholders but a transfer of surplus to capital so as to be no longer distributable; while an ordinary dividend is a distribution of profits which the cor-

poration makes and the stockholder realizes. Moreover, it is said that the stock dividend in the pending case cannot fairly be described as a dividend payable to the Railroad Company within the meaning of the contract, because otherwise the interest of the Railroad Company in the Richmond-Washington Company, that originally amounted to a one-sixth interest, would be reduced to a one-ninth interest, and the security of the bondholders would be impaired.

"These authorities and others like them, present the reasoning upon which is founded the so-called Massachusetts rule governing the apportionment of dividends between life tenant and remainderman under a trust set up by a will or deed. This rule is that stock dividends, regardless of their source, are invariably treated as corpus, and cash dividends are classified as income. If it is applied by analogy to the facts of the pending case, we must hold that the stock dividend in question belongs to the trustee under the mortgage. *But the Massachusetts rule, although favored in the federal courts and in other jurisdictions, is not recognized in the law of Maryland. By a long line of decisions of the Court of Appeals of Maryland, a different theory known as the Pennsylvania rule was firmly embedded in the law of the State when the mortgage under consideration was executed in 1900 and there remained until it was repealed by Chapter 580 of the Laws of Maryland of 1939.*" (Italics supplied.)

There appear to be no cases, in Maryland or elsewhere, directly involving the particular question of the nature of a stock dividend and the rights as between pledgor and pledgee where dividends are reserved to

the former, but a clearly analogous question has been repeatedly litigated, viz.: the rights in and the nature of a stock dividend as between life tenants and remaindermen under trusts of corporate stocks. This question, arising many times in the courts of nearly every State, has given rise to divergent views, which have crystalized into two opposing legal attitudes, generally referred to as the "Pennsylvania Rule" and the "Massachusetts Rule." Generally speaking, the Maryland decisions follow the Pennsylvania Rule with variations immaterial to the principle applicable to the question at issue here.

The Pennsylvania and the Maryland decisions, followed in many other States, treat a stock dividend as income rather than as corpus, thus giving such stock to the life tenant rather than vesting title in the remainderman. The Massachusetts rule generally holds the contrary and treats stock dividends as part of the corpus and refuses the stock to the life tenant. Some decisions take a middle ground (sometimes in an effort to carry out the supposed intention of a testator or creator of a trust) and divide the dividend stock between the life tenant and the remainderman under a formula designed to preserve unimpaired the value of the original stock held in trust, while at the same time giving the life tenant a part of the dividend stock regarded as an equivalent of the proper proportion of the corporate surplus which but for the stock dividend would have been distributed as cash dividends. See Notes 24 A. L. R. 9; 50 A. L. R. 375; 72 A. L. R. 981, and 83 A. L. R. 1261.

The Maryland rule clearly holds that stock dividends declared out of surplus income are to be treated

as income and in principle clearly repudiates contentions such as those accepted by the court below that a stock dividend is not a dividend at all. The rule was adopted by the Court of Appeals of Maryland in the case of *Thomas* v. *Gregg*, 78 Md. 545, 28 Atl. 565, and was reaffirmed in, and applied to, the varied circumstances of numerous subsequent cases until its repeal by Chapter 580 of the laws of Maryland in 1939.

Quinn v. *Safe Deposit and Trust Co.*, 93 Md. 285, 48 Atl. 835;
Smith v. *Hooper*, 95 Md. 16, 51 Atl. 844;
Safe Deposit and Trust Co. v. *White*, 102 Md. 73, 61 Atl. 295;
Ex Parte Humbird, 114 Md. 627, 80 Atl. 209;
In re Northern Central Ry. Dividend Cases, 126 Md. 16, 94 Atl. 338;
Miller v. *Safe Deposit and Trust Co.*, 127 Md. 610, 96 Atl. 766;
Krug v. *Mercantile Trust and Deposit Co.*, 133 Md. 110, 104 Atl. 414;
Spedden v. *Norton*, 159 Md. 101, 150 Atl. 15;
Baldwin v. *Baldwin*, 159 Md. 175, 150 Atl. 282;
Heyn v. *Fidelity Trust Co.*, 174 Md. 639, 1 Atl. (2d) 83.

Without regard to this clear expression of the Maryland rule, or the admonition of this Court that "the proper function of the * * * Federal Court is to ascertain what the State law is, not what it ought to be" (*Klaxon Co.* v. *Stentor Elec. Mfg. Co.*, 313 U. S. 487, 497, 85 L. Ed. 1477, 1481), the Circuit Court stated that to apply the rule established by analogous decisions of the Court of Appeals of Maryland would

be to indulge in vain speculations. And yet, as noted by its dissenting member, there is no other guide, and the Circuit Court, itself, supported its conclusion by the citation of analogous decisions of jurisdictions that have adopted the "Massachusetts Rule"—the rule repudiated by the Court of Appeals of Maryland.

The "available data" upon which to determine what the law is being analogous decisions, obviously the decisions of this Court required the Circuit Court to reason from analogous Maryland decisions and not attempt to establish a "superior rule" by analogy from contrary decisions of other jurisdictions.

II.

The Lien of the Receivers' Certificates Attached to Both Stock and Cash Dividends.

For convenient emphasis we quote again the language of the decrees providing for the lien of the Receivers' Certificates:

> "(1) upon the surplus earnings and income hereafter coming into the hands of the Receivers prior to the termination of the Receivership, after paying out of such earnings and income, however derived, the expenses of the Receivership and of operation, and such other amounts for similar purposes as the Court may direct, and upon any property or interest therein purchased with such surplus earnings and income;
>
> "(2) upon all the property and assets of every nature and description of the Railway Company and of the Receivers, whether real,

personal or mixed, now or at any time hereafter, prior to the termination of the Receivership, in the possession or under the control of the Receivers (including, without limitation of the foregoing general description, securities, equipment obligations, evidences of indebtedness, rolling stock, other equipment, and the interest of the Railway Company and of the Receivers in equipment under equipment agreements); and

"(3) upon all the property and assets, real, personal or mixed, which are surrendered or conveyed by the Receivers to any successor to the Receivers and which are subject to the lien of the Receivers' Certificates at the time of such surrender or conveyance, and upon the rents, income, issues and profits thereof; and upon all property thereafter acquired by the successor to the Receivers which is appurtenant to and used in connnection with the lines of railroad and other property then remaining subject to the lien of the Receivers' Certificates, and all the rents, income, issues and profits therefrom;

prior to any lien thereon, direct or indirect, of the following general mortgages of the Railway Company, viz.:

"First Mortgage, dated April 14, 1900, to The Continental Trust Company, Baltimore, Maryland, Trustee, and all supplements thereto;

"Refunding Mortgage, dated October 1, 1909, to The New York Trust Company and Mortimer N. Buckner, as Trustees; * * *."

(R. 125).

In the teeth of this all-inclusive language the

majority opinion of the Circuit Court of Appeals summarily disposes of this important question in the following language:

> "So far as the claim of lien by reason of the issuance of Receivers' Certificates is concerned, it is a sufficient answer that no holder of any of these certificates is before us claiming any such lien. We do not interpret the orders authorizing the certificates, however, as creating such lien. These orders created a first lien on the property of the Seaboard 'in the possession or under the control of the Receivers,' but this did not reach the shares of stock of R-W Company since they were not in the Receivers' possession or under their control. It is true that the certificates covering the stock dividend shares were in their possession, but these certificates were not the shares of stock, which are intangible rights, but mere evidence thereof. The original shares had been pledged with the trustee and were not in any sense in the possession of the Receivers; and the stock dividend shares, as we have shown, attached to these as a matter of law. The stock certificates, of course, had none of the attributes of negotable paper.
>
> "The shares, it should be noted, were not mentioned in the orders authorizing the certificates. It is true that they were listed as free assets in an inventory furnished the Court at the time of the application for the orders; but the inventory was furnished to show the financial condition of the company as a justification for the orders. No issue was presented as to whether the shares were free assets or not; and the orders contain no provision which could properly be construed as subjecting to the

> lien of the Receivers' Certificates any stock subject to the lien of a pledge. There is no contention that the original 4,450 shares were subjected to the lien of the certificates; and we think that stock dividend shares stand on precisely the same footing."

One of the grounds stated in this quotation for rejection of the Receivers' contentions, properly made on behalf of the numerous holders of Receivers' Certificates, is that although the decrees created a first lien on the property of the Seaboard in the possession or under the control of the Receivers,

> "this did not reach the shares of stock of the R-W Company since they were not in the Receivers' possession or under their control. It is true that the certificates covering the stock dividend shares were in their possession, but these certificates were not the shares of stock, which are intangible rights, but mere evidence thereof."

The fallacy of this contention is emphasized by the language of the decree of the Receivership Court, dated May 29, 1931, extending the Receivership to the properties covered by the First Mortgage on the Bill of Complaint of the Trustee to foreclose that mortgage which explicitly provides

> "That the Receivers heretofore appointed * * * be and they hereby are appointed * * * Receivers of all and singular the railroads, rolling stock, equipment, franchises, rights, interests, property and premises of every kind and description and wheresoever located, belonging to the defendant, Seaboard Air Line

> Railway Company, and covered by and embraced in or under said First Mortgage (other than the securities and other property pledged to *and now in the possession of the complainant*, The Continental Trust Company) situate within the jurisdiction of this Court, and of the tolls, earnings, income, rents, issues and profits of the same and every part thereof, * * *."* (Italics supplied.)

It ignores the fact that the First Mortgage Trustee did not have possession or control of the shares and does not have to this day. It did not hold these shares in pledge, for there has never been any delivery, and does not now hold them in pledge. The most the Trustee could have is to convert an inchoate right of pledge into a positive one and have these shares subjected to the lien of the Mortgage. With due deference to the majority of the Court of Appeals, it seems absurd to say that the stock dividend having been declared to the Railway Company and the stock certificates for 2,225 shares delivered to the Receivers, they and the Court, of which the Receivers are merely the instrumentality, did not have possession and control of the shares.

The other reason given by the majority opinion is equally fallacious, viz.: That "no holder of any of these certificates is before us claiming any such lien." The Receivers' Certificates were issued by the Receivers pursuant to decrees of the Court. Under the terms of the decrees authorizing the issuance of the

---

* This decree is not a part of the record printed pursuant to stipulation by the parties for the purpose of this petition, but is a part of the typewritten transcript of the entire record on file with the Clerk of this Court.

Receivers' Certificates the Receivers are entitled to the income on all assets, both real and personal, subjected to the lien of the certificates. Accordingly, apart from the fact that the Receivers can be said to be representatives of the Receivers' Certificates in a trust relationship and under a duty to protect their interests the Receivership Estate itself has a direct interest in the continued receipt of the income from these shares of stock. (See the Decree—Order 160A —R. 130).

The intention to subject to the lien all securities and choses in action in the possession of the Receivers could hardly be more clearly and directly expressed. We have shown beyond any possible doubt that it was the intention of the Receivers to include these shares in the pool of free assets to be subjected to the lien of the Receivers' Certificates; that there was ample notice to the Trustees of this intention through their counsel who were present at the hearings by the testimony of R. P. Jones on the hearing on Application No. 19 and the introduction of the statement of unpledged securities (R. 111), and through the Receivers' Application No. 28, served June 9, 1931 (see *ante*, p. 17 of this brief) the Receivers were dealing with and exercising open dominion of these shares.

No contention has been made that the Court lacked the essential power to subject the 2,225 shares to the lien of the certificates, but the argument is that there was no intention of the Court to do so. If, however, such intention, express or implied from the circumstances shown by the record on those hearings did exist, any intention of the Mortgage Trustee to the contrary, not disclosed at the hearings, is immate-

rial because they could not remain silent and now be heard to say that the record as made on the Receivers' Certificates applications is not one upon which the holders of Receivers' Certificates could rely for the nature and extent of the security extended by the Court decrees to the certificates.

It is a thoroughly accepted principle that a judgment or decree is conclusive, not only upon the questions actually decided and determined but upon all matters which might have been litigated and decided in the suit and within the scope of the proceeding. Accordingly, where the second suit or proceeding relates to the same subject matter as the first, all matters which might have been litigated are conclusively settled by the former judgment or decree and the rule applies where defenses which were available in the first proceeding, but not then set up, are sought to be used in the second action either by way of defense or as the foundation for a claim for relief.

Town of Beloit v. *Morgan*, 74 U. S. 619, 19 L. Ed. 205;
Cromwell v. *Sac County*, 94 U. S. 351, 24 L. Ed. 195;
New Orleans v. *Citizens' Bank*, 167 U. S. 395, 42 L. Ed. 202;
Southern Pacific R. R. Co. v. *United States*, 168 U. S. 1, 42 L. Ed. 355;
Fitch v. *Stanton Tp.* (C. C. A. 8), 190 Fed. 310.

The entire record on Application No. 19 (including the statement of unpledged securities introduced at that hearing, above referred to) was re-introduced and made a part of the record on the hearings of both

Applications Nos. 63 and 160. The Trustees of both the First Mortgage and of the Refunding Mortgage were parties to the two later proceedings. The Receivers were under no more obligation to make pointed reference to the 2,225 shares of stock in connection with the proposed lien of the Receivers' Certificates than they were to single out and make specific allusion to a particular line of railroad or other property of the Railway Company. If the Trustees of the mortgages regarded their claims to the stock to be such that the lien of the certificates could not be imposed thereon, it was incumbent upon them to put forward that contention as an issue to be then and there decided by the Court.

It is not necessary to ground the validity of the lien of the Receivers' Certificates upon the elements of estoppel plainly apparent from the record, but discounted in Section VI of the Master's report (R. 182 et seq.). For as we view the case the Receivers' Certificates decrees are binding upon the Trustee, regardless of any question of estoppel. But the argument in the report on this point is that "the Receivers have not been adversely affected in any way by the silence of the Trustees." The Receivers are officers of the Court, and the argument of the report ignores the clear fact that to permit the Trustee now to seize possession of the stock would be to impair the value of the security of the Receivers' Certificates to the extent of several hundred thousand dollars. Whether the silence and inaction of the Trustee (apart from the cash dividends involved, the book value of the 2,225 shares is nearly $400,000, see p. 14, *ante*.), be regarded as estoppel

in pais, estoppel by record or a mere waiver of their rights now asserted, the result is the same. Compare:

> *Mercantile Trust Co.* v. *Tennessee Cent. R. Co.* (M. D. Tenn., 1921), 291 Fed. 462;
> *Mercantile Trust Co.* v. *Kanawha R. Co.* (C. C. A. 6th, 1893), 58 Fed. 6;
> *Kneeland* v. *Luce Co.* (1891), 141 U. S. 491, 35 L. Ed. 830;
> *Miltenberger* v. *Logansport, Etc. R. R. Co.* (1882), 106 U. S. 286, 27 L. Ed. 117;
> *Pillinger* v. *Beaty* (C. C. A. 4th, 1920), 265 Fed. 551.

As to the collection by the Receivers of cash dividends on both the 4,450 shares and on the 2,225 shares, there was a clear waiver of the right of the Trustee to reclaim them from the Receivers.

Nor is it material that the result of these decrees has been to displace or subordinate the claims of the Mortgage Trustee to the stock and cash dividends. The act of the Court in the form of the decrees in subjecting the stock is inescapable. On this phase of the case the report of the Master (R. 162 et seq.) proceeds upon what, we submit, is an entirely erroneous conception of the effect of the decrees. It says:

> "If the stock dividend and the cash dividends had been, when the orders in question were made, free assets of the Railway, I agree with the Receivers that they would have become thereby subject to the lien of the certificates. The applications and the orders were broad enough to cover them. I have tried to show that they were not free assets of the Railway, but were held, just as the original

> 4,450 shares were held under the pledge to the Trustee of the First Mortgage. This would sufficiently dispose of this question if there were no more to the contention of the Receivers. But, as I understand it, the Receivers go far beyond this, and make the claim that, even though, in the absence of the orders in question, the dividends in question might have been subject only to the pledge of the First Mortgage Trustee or to that of the Refunding Mortgage Trustees, these orders have had the effect of deciding that these dividends were not pledged under either of these mortgages, but were a part of the free assets of the Railway. In other words, the Receivers make the contention that, when the first of these applications was before the Special Master and the Court, respectively, and afterwards when the second and third were before the Court, the question was squarely raised and put in issue, as to whether the stock dividend, was or was not pledged, and that by the orders entered upon these applications it was adjudged that it was unpledged."

The report assumes that in order for the lien of the Receivers' Certificates to have become fixed upon the stock and upon the cash dividends that had come into the hands of the Receivers, the stock and the cash must have been free assets of the Railway Company, but the report argues that the shares were not free assets but "were *held* under the pledge to the Trustee of the First Mortgage." The report makes the point that this stock was not listed in the exhibits to Application No. 19 as a free asset. That is true, but the report itself comments upon the fact that:

> "Among the exhibits was Exhibit C-1, showing the securities pledged under the several gen-

> eral mortgages of the Railway. In this exhibit the 4,450 shares of R-W Co. stock were listed as pledged under the First Mortgage. There was no statement in the application showing what were the unpledged securities * * *. The prayer of the application was that the certificates be equally secured 'by a paramount lien upon the properties and assets of every nature and description of the Railway and/or of the Receivers (including * * * without limitation * * * securities and evidences of indebtedness and all other personal property) * * * in the possession or under the control of the Receivers,' * * *."

It is difficult to conceive of a broader statement than that quoted by the report itself of the intention in the application to subject to the lien of the certificates all and every class of securities then in the possession of the Receivers. That intention is not limited so as to exclude securities the status of which, as here, might later become the subject of controversy. The fact that the application does not list the 2,225 shares as among those pledged under the First Mortgage in connection with the notice in the various forms already discussed and the fact that the Receivers had the possession of and claimed the title to the 2,225 shares, provided an ample basis for the decrees, whose language, wholly free of any ambiguity, subjected this stock to the lien of the certificates.

The authority and power of the District Court to displace the lien of the First Mortgage upon the 2,225 shares and upon the cash dividends collected by the Receivers on both those shares and upon the 4,450 pledged shares, even if such a lien existed, is well established:

Wallace v. *Loomis*, 97 U. S. 146, 24 L. Ed. 895;
Union Trust Co. v. *Illinois Midland Co.*, 117 U. S. 434, 29 L. Ed. 963;
American Brake Co. v. *Pere Marquette R. R. Co.* (C. C. A. 6, 1913), 205 Fed. 14;
Mercantile Trust Co. v. *Tennessee Central R. Co.* (M. D. Tenn., 1921), 291 Fed. 462.

As stated by the Court in the case last cited (p. 467):

> "A court of equity administering railroad property either in a mortgage foreclosure case or in a creditors' suit, is charged with the duty of conserving and operating the property, so far as can practically be done, for the benefit of both public and private interests, and in the exercise of this duty of conservation and operation may, in a proper case, make such repairs, replacements and betterments and incur such operating expenses as are purely essential to such results, and make the certificates issued for money borrowed by the Receivers for such purposes a lien upon the corpus of the property, and, so far as necessary, prior to existing liens."

There are no limits to the power of a Court to subject to the lien of Receivers' Certificates all assets within its jurisdiction.

Under the decisions of this Court even prior notice to parties and lienholders is not essential to the validity of an order of a Court authorizing the issuance of Receivers' Certificates, which shall be a first lien on the property:

Union Trust Co. v. *Illinois Midland R. Co.*, *supra;*

Mercantile Trust Co. v. *Tennessee Central R. Co., supra;*
American Brake Co. v. *Pere Marquette R. Co., supra;*
Ames v. *Union Pacific R. Co.* (C. C. D. Nebr., 1896), 174 Fed. 335.

Secured creditors who are not parties to the suit when Receivers' Certificates are authorized have the right, however, to intervene and contend that the order displacing their liens should be reconsidered.

Considered even from that standpoint, it is submitted that there are no equities in favor of the Trustees. Though the Receivers' Certificates supplanted the liens of the mortgages, the testimony and evidence in records on the hearings of the Receivers' Certificates applications show conclusively that issuance of the certificates was necessary to the protection of the mortgaged properties and the preservation of the system. Under these circumstances the Court will do no violence to the rights or equities of the mortgages if it refuses to impair the security of the certificates by removal therefrom of the 2,225 shares and refuses to require the Receivers to pay over to either of the Mortgage Trustees the amounts of the cash dividends collected by the Receivers on both the 4,450 shares and the 2,225 shares and expended by them in good faith for the legitimate purposes of the Receivership. The Trustees of the Mortgages long since invoked the aid of the Court to preserve and manage the mortgaged properties in the interests of those respective trusts. They now seek the aid of the Court to capture and reduce to possession the stocks and cash and remove them beyond the jurisdiction of the Court, and of

the scope of the Receivership. Such aid should be denied.

The value of the 2,225 shares of nearly half a million dollars is a material asset involved in the appraisals of values of the Railway properties and existing securities in connection with proceedings for reorganization of the Seaboard System which are now pending. Moreover, the importance of giving effect to decrees of Receivership Courts upon the faith of which Receivers' Certificates are acquired by the investing public, is such that this question also deserves review and consideration by this Court.

CONCLUSION.

We think it sufficiently appears the questions presented in this case are of such a nature as to justify the assertion that the case comes within the provisions of paragraph 5(b) of Rule 38, which states the considerations controlling in the matter of issuing writs of certiorari in cases like this, and it is respectfully submitted that the petition should be granted.

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For Petitioners.

March 5, 1942.

APR 2 1942
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 1021.

LEGH R. POWELL, JR., AND HENRY W. ANDERSON, AS RECEIVERS OF THE PROPERTIES OF SEABOARD AIR LINE RAILWAY COMPANY,

Petitioners,

against

MARYLAND TRUST COMPANY, AS SUCCESSOR TRUSTEE UNDER THE FIRST MORTGAGE OF SEABOARD AIR LINE RAILWAY DATED APRIL 14, 1900.

Respondent.

BRIEF ON BEHALF OF MARYLAND TRUST COMPANY, AS SUCCESSOR TRUSTEE UNDER THE FIRST MORTGAGE OF SEABOARD AIRLINE RAILWAY, IN OPPOSITION TO THE PETITION AND BRIEF OF LEGH R. POWELL, JR., AND HENRY W. ANDERSON, AS RECEIVERS OF SEABOARD AIR LINE RAILWAY COMPANY, FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

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The Daily Record Co. Print, Baltimore.

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OPINIONS OF THE COURTS BELOW.

The Report of Special Master James E. Heath, to whom this case was referred by the District Court for the Eastern

District of Virginia, is printed at page 132 of the Record. The opinion of the District Court, confirming and modifying the Report of the Special Master, is printed at page 185 of the Record and has not yet been officially reported. The opinion of the Circuit Court of Appeals appears at page 199 of the Record and is officially reported in 125 Fed. (2d) page 260.

JURISDICTION.

Jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (Chapter 229, 43 Stat. 936).

STATEMENT OF THE CASE.

The facts are not in dispute and have been agreed upon in a Stipulation of Facts. In the opinion of counsel for the First Mortgage Trustee, the detailed statement appearing in the Receivers' brief tends to confuse the limited issues raised by their petition. In the interest of clarity and conciseness, therefore, it is deemed desirable to make a short statement of only those facts which are essential to the questions to be decided.

At the outset, it should be said that this controversy involves the disposition of 2,225 shares of the capital stock of the Richmond-Washington Company, a corporation of the State of New Jersey (hereinafter referred to as R-W Company) and certain cash dividends amounting (when these proceedings were commenced) to $142,956.25. The 2,225 shares of stock were paid on October 31, 1930 as a 50% stock dividend upon 4,450 shares of the stock of that company held in pledge by the Maryland Trust Company, Successor Trustee under the First Mortgage from Seaboard Air Line Railway (hereinafter referred to as Seaboard) dated April 14, 1900. The cash dividends were

paid by the R-W Company upon both the 4,450 shares of stock held by the First Mortgage Trustee and upon the 2,225 shares. All the cash dividends in question were paid at various dates after the appointment on December 23, 1930 of Receivers for Seaboard.

The contention of the Maryland Trust Company is that under the terms of the First Mortgage, under which it is acting as Successor Trustee, it is entitled to the 2,225 stock dividend shares and to all of the cash dividends referred to. Its position is that the stock dividend did not come within the reservation of dividends in favor of Seaboard under the terms of Section 1 of Article Three of the First Mortgage (R. 47) and that these shares, upon their declaration and payment, became a part of the original pledge of the 4,450 shares of R-W Company stock theretofore held in pledge. As to the cash dividends, the position of the Maryland Trust Company is that under the terms of the First Mortgage, the appointment of the Receivers constituted an event of default which terminated the right of Seaboard to receive any further dividends of any character whatsoever paid upon the pledged securities.

A third claimant to the stock dividend and to the cash dividends paid upon said stock dividend is The New York Trust Company, Trustee under the Refunding Mortgage from Seaboard Air Line Railway dated October 1, 1909. By the terms of that Mortgage, Seaboard agreed to pledge with the original trustees thereunder, at that time Mortimer N. Buckner (whose death occurred after these proceedings were commenced) and The New York Trust Company, all shares of R-W Company stock thereafter acquired by Seaboard. The claim of The New York Trust Company becomes an issue only in the event that the stock dividend is not awarded to the First Mortgage Trustee.

The late James E. Heath, the Special Master appointed by the District Court to pass upon these matters, concluded that the First Mortgage Trustee was entitled to the 2,225 stock dividend shares and to all of the cash dividends, including both the dividends paid upon the original 4,450 shares as well as to those paid upon the 2,225 stock dividend shares. The opinion of the Special Master was affirmed by the District Court with one exception not material to state here. The decree of the District Court was sustained by the Circuit Court of Appeals except as it modified the conclusions reached by the Special Master. The case now stands, therefore, as the Special Master originally decided it.

The First Mortgage was executed in the year 1900 to secure a large issue of bonds, of which $12,768,000 principal amount are now outstanding in the hands of the public. As security for these bonds, Seaboard mortgaged its main line of railway and lodged with the Trustee various bonds and stocks. A provision in the Mortgage permitted Seaboard to pledge further securities with the Trustee and, acting under this authority, Seaboard pledged with the First Mortgage Trustee, in December, 1901, certificates representing the 4,450 shares of the capital stock of the R-W Company. These shares were, and have at all times continued to be, subject to the lien of the First Mortgage.

Section 1 of Article Three of the Mortgage (R. 47) provides that unless Seaboard shall be in default, it shall be entitled to receive "all interest paid or dividends declared in respect of any bonds or stocks transferred to or pledged with the Trustee". The question raised by the Receivers is whether this reservation of dividends in favor of Seaboard is broad enough to include stock dividends as well as cash dividends. The answer depends upon the

proper construction of the First Mortgage and it is admitted by all parties that State law is controlling. The Receivers insist that the applicable State law is the law of the State of Maryland and that under the Maryland decisions, properly construed, Seaboard became entitled to the stock dividend paid by the R-W Company. While admitting that State laws control, the First Mortgage Trustee has at all times contended that the construction of the reservation of dividends, as used in the First Mortgage, is governed by the law of Virginia and North Carolina, the domicile of Seaboard at the time of the creation of the First Mortgage. For the purpose of this brief, however, the case will be argued as though all questions in connection with the pledge and the construction of the First Mortgage are controlled by the law of Maryland.

The Receivers have raised an additional question which involves a consideration of the Receivers' Certificates issued pursuant to Receivers' Applications Nos. 19, 63 and 160 (R. 87). The cash dividends and the certificates representing the stock dividend were in the possession of the Receivers at the time the Receivers' Certificates were issued. The Receivers argue, therefore, that these dividends as well as the railway properties of Seaboard became subject to the lien of the Receivers' Certificates.

ARGUMENT.

The argument of the First Mortgage Trustee will be divided into two classifications, the first designed to show that there are no special circumstances within the meaning of Rule 38 of this Court justifying a review of this case, and the second, that irrespective of any other consideration, a review should be denied because the opinion of the majority of the Circuit Court of Appeals was in conformity with applicable State law.

I.

NO SPECIAL OR IMPORTANT REASONS EXIST WHICH JUSTIFY A REVIEW OF THIS CASE.

Paragraph 5 of Rule 38 of the rules of this Court furnishes a guide as to matters which are reviewable upon a petition for a writ of certiorari. It is there stated that a review is not a matter of right but of sound judicial discretion and "will be granted only where there are special and important reasons therefor". It is submitted that no such special or important reasons justify a review in this case. On the contrary, it is in the public interest that the pending plans for the reorganization of Seaboard (already over eleven years in receivership) be completed as promptly as possible. Further litigation of the important issues involved herein can only delay and retard that objective.

The questions involved here have been passed upon at three different stages, first by a Special Master appointed by the District Court for the Eastern District of Virginia, subsequently by the District Court itself and, finally, by the Circuit Court of Appeals for the Fourth Circuit. Except for the dissenting opinion of Judge Soper, which is limited solely to one issue, the opinions have been unanimous in holding that the First Mortgage Trustee is entitled to the stock dividend shares. It would not seem that the Receivers, being neutral parties and mere officers of the District Court, are justified in litigating these matters further. This is particularly true of the question pertaining to the effect and scope of the lien of the Receivers' Certificates. The holders of these Certificates have been represented by a committee from the time of the Receivership and it is pertinent to observe that at no stage of the proceedings has the committee thought it necessary to intervene or to take any active part in this controversy.

Chief Judge Parker commented upon this. He said (R. 217):

> "So far as the claim of lien by reason of the issuance of receivers' certificates is concerned, it is a sufficient answer that no holder of any of these certificates is before us claiming any such lien."

The Receivers' petition is justified, if at all, only by the provisions of paragraph 5(b) of Rule 38 of this Court which permits a review where a Circuit Court of Appeals "has decided an important question of local law in a way probably in conflict with applicable local decisions". The disposition of the stock dividend depends in the final analysis upon the meaning to be attached to the reservation of dividends by Seaboard under the First Mortgage. If, under that reservation, stock as well as cash dividends were covered, then unquestionably the Receivers of Seaboard are entitled to the 2,225 stock dividend shares, but if, on the contrary, the parties intended only cash dividends, then it clearly follows that the stock dividend shares should be awarded to the First Mortgage Trustee.

It is submitted that there are no grounds to support the dissenting Judge's conclusion that the reservation of dividends under Article Three, Section 1, coupled with other provisions of the Mortgage, demonstrated an intent on the part of Seaboard to reserve all income upon the pledged securities. Article Nine of the Mortgage upon which the dissenting Judge relied (R. 64) is confined solely to the rights of Seaboard over the railroad properties subject to the Mortgage. As to these, Seaboard clearly reserved the right to all profits, earnings and income. But Seaboard's rights *as pledgor* are governed exclusively by Article Three, entitled, "As to Stocks and Bonds Here-

under". Whatever Seaboard's unexpressed intent may have been, its written contract is controlling. As will be shown, in the absence of some agreement to the contrary, the common law awards all dividends, both cash and stock, to the pledgee. The field of inquiry, therefore, of necessity turns upon the meaning of the word "dividends" as used in the reservation under Section 1 of Article Three.

The majority of the Circuit Court of Appeals recognized this to be the turning point of the case and they recognized, all of them, that under the decision of Erie Railroad v. Tompkins, 304 U. S. 64, State law is controlling. It was said in the majority opinion (R. 203):

> "The mortgage was delivered to the first mortgage trustee and accepted by it in Baltimore, Maryland, and the shares of stock which were pledged were delivered to it there; and there is no serious question but that the law of Maryland is the law properly applicable in determining the rights of the parties with respect to the stock dividend."

The same conclusion was reached by the Special Master and the District Court.

Now the stumbling block in this controversy is the fact that there is no Maryland case, nor any decision in any other jurisdiction, precisely in point. A review of the various opinions in this case shows this to be so. The Special Master said (R. 145):

> "There is no Maryland case precisely in point * * * that is to say, no Maryland case construing the same or a similar reservation in a pledge of stock. But, upon principle, I think the claim of the First Mortgage Trustee is sound and *I am also of the opinion that the Maryland Court has clearly indicated that it is in accord with this view.*" (Italics ours.)

And in the opinion of the majority of the Circuit Court of Appeals, it was said (R. 204):

> "The precise question is not covered by any Maryland decision; but it is worthy of note that in the case of Smith v. Hooper, 95 Md. 16, 51 Atl. 844, Chief Judge McSherry quotes with approval from Stoner v. Phillips, 62 Conn. 62, 24 Atl. 524, 16 L. R. A. 461, 'that the word "dividend", if unqualified, signifies dividends payable in money.' "

Judge Soper, dissenting, made a similar admission, (R. 221):

> "We are obliged in the pending case to search for and apply the Maryland law in the interpretation of a trust indenture from a railroad company to a trustee to secure an issue of mortgage bonds, *and to construe a clause of the contract that is without precise precedent in judicial decision in Maryland or elsewhere, so far as search of the authorities has disclosed.*" (Italics ours.)

And the Receivers in their brief say:

> "There appears to be no cases, in Maryland or elsewhere, directly involving the particular question of the nature of a stock dividend and the rights as between pledgor and pledgee where dividends are reserved to the former, * * *"

It cannot be said that the majority of the Circuit Court of Appeals failed to recognize or to give full effect to the doctrine of the Erie Railroad case and to all of its implications as set forth in such cases as Ruhlin v. New York Life Insurance Co., 304 U. S. 202 and West v. American Tel. & Tel. Co., 311 U. S. 223, which hold that a Federal court, exercising jurisdiction on grounds of diversity of citizenship, must search for and apply the entire body of substantive law governing an identical action in the State courts. The majority recognized that such law is to be ap-

plied rather than to prescribe a different rule, however superior it may seem from the viewpoint of general law and however much the State law may have departed from prior decisions of the Federal court.

In its effort to follow the Erie Railroad rule, the majority carefully sifted and analyzed the various Maryland decisions. Reliance was placed upon the case of Gemmell v. Davis, 75 Md. 546, 23 Atl. 1032, which holds that the pledgee is entitled to all dividends upon pledged securities. Reliance was also placed upon the important case of Smith v. Hooper, 95 Md. 16, 51 Atl. 844, in which it was held by Chief Judge McSherry that the word "dividend", if unqualified, signifies dividends payable in money. The court rejected, properly so for the reasons enumerated on page 21 of this brief, the Maryland trust apportionment rule. That rule, now abrogated by statute, can have no application to a pledge where the issue turns upon the precise legal meaning of the reservation of "dividends" as used in the contract of pledge. Notwithstanding any statements in the dissenting opinion of Judge Soper to the contrary, the only charge that the dissenting Judge can lodge against the majority is that they failed to agree with his conclusions first, that Seaboard reserved all income, rather than merely dividends, upon pledged securities and second, that the Maryland trust rule of apportionment is applicable by way of analogy. There is nothing to warrant his statement that the majority in any way failed to give full scope and effect to the Erie Railroad decision. In support of the majority it should be said that the dissenting Judge could point to no Maryland case holding the analogy to be sound.

A careful analysis of both the majority and dissenting opinions reveals that the different results reached stems from the inability of members of the court to agree upon

the construction to be given to the First Mortgage. Judge Soper concluded that Seaboard intended to and in fact did reserve all income upon the pledged securities. In order to support his position, it is necessary to read into the Mortgage not only a reservation of income in favor of Seaboard but a reservation only of income which accrued after the date of the creation of the Mortgage, but not prior to that time. In accordance with the Maryland Trust apportionment rule which he accepted and applied, the dissenting Judge would have awarded the Trustee so much of the stock dividend as was paid from earnings, had there been such, accumulated prior to the date of the pledge. This, however, requires reading something into the contract of pledge which does not exist. Chief Judge Parker, speaking for the majority, correctly said, "No such question is presented here. There is no reservation of income to the Seaboard." The inability of the court to agree upon the construction of the Mortgage does not present a question of local law. No search of authorities would be of particular assistance in the solution of this question. It must be resolved in each instance by the court before whom the question arises.

The Receivers as well as the dissenting Judge object to the reliance placed by the majority upon such cases as Kaufman v. Charlottesville Woolen Mills, 93 Va. 673, 25 S. E. 1003, and Lancaster Trust Co. v. Mason, 152 N. C. 660, 68 S. E. 235, and to the line of Federal decisions commencing with Gibbons v. Mahon, 136 U. S. 549. It is submitted that it was entirely proper for the court to look for guidance to these decisions. Particularly is this true of the Kaufman and Lancaster Trust Co. cases, because the questions there at issue were the effect to be given to a reservation of dividends under contracts of sale. The Spe-

cial Master grasped their full significance when he said in his Report (R. 148):

> "It should be emphasized just how apposite these two decisions are. They dealt, not with testamentary trusts, but with the rights of the parties to a contract, and their reasoning was based upon the essential difference between a stock dividend and a cash dividend, that is to say, upon the fact that the former was not really a dividend."

In rejecting the applicability of the Maryland trust apportionment rule to a pledge situation, the majority simply refused to follow a line of cases which, in their judgment and on the facts of this case, they felt the Maryland Court of Appeals itself would never have followed or applied. Upon this point, Judge Parker quite properly said (Record, p. 212):

> "To apply the rule which they lay down with respect to the rights of life tenant and remainderman to the question before us, instead of the rule prescribed by reason for such a situation, is not required by Erie Railroad Co. v. Thompkins, 304 U. S. 64, or by any other decision. To reason from analogy and apply the rule because of what we may guess the Maryland court would have decided if the case had been before it, is to indulge in vain speculation."

It is to be observed in this connection that in 1939, the Maryland Legislature discarded the trust apportionment rule in favor of the Federal or Massachusetts rule. See Flack's Annotated Code of Maryland, Volume II, Article 75B. The apportionment rule, with its host of practical difficulties in operation having been abolished by legislative fiat, it cannot be supposed that a Maryland Court would today lend a hand in its rebirth. To inject this rule again into Maryland law, as the dissenting Judge would have us to, can only lead to conflict and further confusion.

This Court cautioned against this danger in Vandenbark vs. Owens-Illinois Glass Company, 311 U. S. 538. The question at issue in that case was whether the holding of a Federal District Court should have been reversed by the Circuit Court of Appeals because of a change in State law after the opinion of the District Court. The Circuit Court of Appeals refused to disturb the opinion of the District Court and its decision was reversed by this Court. Speaking through Justice Reed, this Court said:

> "While not insensible to possible complications, we are of the view that, until such time as the case is no longer *sub judice*, the duty rests upon federal courts to apply state law under the Rules of Decision in accordance with the then controlling decision of the highest state court. Any other conclusion would but perpetuate the confusion and injustices arising from inconsistent federal and state interpretations of state law."

It cannot be said that the present case bears any resemblance to such decisions as Fidelity Union Trust Co. v. Field, 311 U. S. 169, Six Companies of California v. Joint Highway District, 311 U. S. 180, West v. American Tel. & Tel. Co., supra, and Stoner v. New York Life Insurance Co., 311 U. S. 464. In all of these, the respective Circuits Courts of Appeal intentionally and knowingly refused to follow applicable lower court decisions. Each was reversed in this Court upon the ground that the Erie Railroad case requires a Federal court to follow the applicable decisions of a lower State court in the absence of a decision by the highest appellate court.

Whether the majority of the Circuit Court of Appeals was correct in rejecting the application of the Maryland trust apportionment rule is a question that must forever remain unanswered until decided by a Maryland court. This Court has heretofore shown its reluctance

to indulge in vain speculation as to what the State law might be in the absence of some decision in point. See Helvering v. Fuller, 310 U. S. 69, and Railroad Commission of Texas v. Pullman Co., 312 U. S. 496, 501, and also Ruhlin v. New York Life Insurance Co., supra, at p. 206. And in the recent case of Macgregor v. State Mutual Life Assurance Co., decided February 16, 1942 and reported in the United States Law Week, Vol. 10, Sec. 4, p. 4214, this Court refused to disturb the opinion of the Circuit Court of Appeals for the Sixth Circuit in the absence of a State decision in point. It was there said:

> "No decision of the Supreme Court of Michigan, or of any other court of that State, construing the relevant Michigan law has been brought to our attention. *In the absence of such guidance, we shall leave undisturbed the interpretation placed upon purely local law by a Michigan Federal judge of long experience and by three Circuit judges whose Circuit includes Michigan.*" (Italics ours.)

Somewhat the same line of reasoning was adopted in Railroad Commission v. Pullman, supra, where this Court refused to pass upon a question involving the interpretation of a Texas statute. The Court remanded the cause to the District Court with direction to retain the bill pending a determination of the precise question by a Texas court. It was said at page 499 of the United States report:

> "The lower court did deny that the Texas statutes sustained the Commission's assertion of power and this represents the view of an able and experienced judge of the Circuit which includes Texas and of two capable District judges trained in Texas law. Had we or they no choice in the matter but to decide what is the law of the state, we should hesitate long before rejecting their forecast of Texas law. But no matter

how seasoned the judgment of the District Court may be, it cannot escape being a forecast rather than a determination."

Situations are certain to arise where Federal courts are called upon to decide problems of first impression, and the Courts must of necessity be free to look to all applicable decisions, irrespective of the jurisdiction, and to apply their own reasoning in the solution of the problem to be solved. In the recent case of Lich v. U. S. Rubber Co., for example, reported in 39 Fed. Supp. 675, the District Court for the District of New Jersey felt free to rely upon the definition of a stock dividend as decided by this Court in Eisner v. Macomber, supra. See page 683 of the Report. It is submitted that the correct rule is well summarized in the recent case of Simmons v. Simmons, decided November 6, 1941 by the District Court for the Eastern District of South Carolina and reported in 41 Fed. Supp. 545. The case was one involving a new point of law and in its approach the Court applied much the same line of reasoning as the majority of the Circuit Court of Appeals in the present case. The Court said at page 547:

> "As to this phase, this is a case of novel impression, and it is regrettable that it arises in a Federal court rather than in a court of the State of South Carolina. It is conceded by counsel for both sides that so far as their knowledge goes, this question has not been passed upon by any South Carolina court, but it does not seem to me that it could ever be said that a state has no law upon any given question merely because the precise question has not yet been passed on by any court. It seems to me to be the duty of the court in which the novel question arises to pass upon the question in the light of the pertinent statute law and analogous decisions, *if any, together with the decisions of other states and the court's own idea of reason and principle and public policy.*" (Italics ours.)

II.

THE OPINION OF THE MAJORITY OF THE CIRCUIT COURT OF APPEALS WAS IN ACCORDANCE WITH APPLICABLE STATE LAW.

A. Under Maryland Law, the Reservation of Dividends Under a Contract of Pledge Would Not Include a Stock Dividend.

(1) The rights of the First Mortgage Trustee are dependant upon the Principles of law applicable to pledges.

As Judge Parker observed, the answer to whether the First Mortgage Trustee or the Receivers is entitled to the stock dividend involves a consideration of the law applicable to pledges. These shares were declared as a dividend upon the 4,450 shares of R-W Company stock originally pledged with the First Mortgage Trustee. While the combination of a pledge and trust relationship may at first seem unusual, this situation is common in many deeds of trust where securities are lodged with a trustee to secure an issue of notes or bonds. Jones on Collateral Securities, 3rd Ed., Sec. 34, p. 42; Bogert on Trusts, Vol. 2, Sec. 246, p. 790. Upon analysis, it will be seen that the First Mortgage Trustee occupies a trust relationship with the bondholders. It holds in trust for their benefit the pledged securities, including the 4,450 shares of the stock of the R-W Company. As between Seaboard and the Trustee, a relationship of pledge exists with respect to the pledged securities. It cannot be supposed that the legal effect of a pledge is in any way different because it is made to a trustee.

(2) In the absence of an agreement to the contrary, the pledgee is entitled to all dividends and interest upon pledged securities.

The general rule established by a long line of decisions is that a pledgee of stock is entitled to all dividends paid thereon in the absence of any agreement to the contrary.

The authorities are fully collected in two annotations in American Law Reports, Vol. 67, p. 485 and in Vol. 103, p. 849. See also Railroad Credit Corp. v. Hawkins, 80 Fed. (2d) 818, and Corpus Juris, Vol. 14, Sec. 1243, p. 822 and Sec. 1116, p. 732. The application of this rule extends to *stock* as well as to cash dividends. Whetsel v. Forgey, 323 Mo. 681, 20 S. W. (2d) 523; Peoples-Pittsburg Trust Co. v. Saupp, 320 Pa. 138, 182 Atl. 376. The law of Maryland upon this point is in accord with the general rule and was settled by the case of Gemmell v. Davis, supra.

This Court is asked to decide whether the parties to the First Mortgage changed this rule by their agreement. The question is purely a contractual one between the Trustee on the one hand, as pledgee representing the bondholders, and Seaboard on the other. In view of the common law rights of a pledgee, it is reasonable to assume that Seaboard would have *expressly* reserved stock as well as cash dividends, if it was intended that the Railway Company should have both. Yet it failed to do so. The provisions touching closest upon this question are to be found in Section 1 of Article Three (R. 47) where it is provided that prior to certain events of default, none of which had happened at the time of the payment of the stock dividend in question, the Trustee

> "shall not collect or be entitled to collect the interest of any of the bonds or claims or indebtedness now or hereafter pledged with or assigned to the 'Trustee' under this indenture, and the 'Railway Company' shall be entitled to receive all interest paid or dividends declared in respect of any bonds or stocks transferred to or pledged with the Trustee pursuant to any of the provisions of this indenture."

Admittedly, this provision gave Seaboard, prior to the enumerated events of default, an undoubted right to all

cash dividends. It is submitted, however, that the use of the word "dividends" did not, and was not intended to, include stock dividends.

(3) The reservation of dividends by Seaboard under the First Mortgage did not include stock dividends.

While there is no decision precisely in point, the courts of Maryland, Virginia and North Carolina have passed upon the meaning of the word "dividends" as used in comparable relationships. In Virginia, in the case of Kaufman v. Charlottesville Woolen Mills, supra, the question was whether the purchaser of certain stock or the seller was entitled to a stock dividend declared shortly after the sale. It was a part of the agreement that the seller was to have dividends. Upon the subsequent declaration of a cash and a stock dividend, the seller claimed the right to both. In holding the buyer was entitled to the stock dividend, the court said at page 675:

> *"A stock dividend is not, in the ordinary sense, a dividend;* the latter being a distribution of profits to stock holders as income from their investment. A stock dividend is merely an increase in the number of shares, the increased number representing exactly the same property that was represented by the smaller number of shares." (Italics ours.)

Similar views as to the nature of a dividend have been taken by the courts in North Carolina. In the case of Lancaster Trust Co. v. Mason, 152 N. C. 660; 68 S. E. 235, a case similar to the Kaufman case, supra, the question was whether the seller of stock, reserving "January dividends" was entitled to stock as well as to cash dividends declared upon the stock. The court held the buyer was entitled to the stock dividends. These cases are entitled to particular consideration because they deal, not with testa-

mentary trusts but with the rights of the parties to a contract. Their reasoning is based upon the essential differences between a stock and a cash dividend.

In Maryland also the word "dividend" has been held to signify dividends payable only in cash. In the case of Smith v. Hooper, 95 Md. 16, 51 Atl. 844, where the court was required to pass upon the true meaning of a dividend as distinguished from the question of income, the Maryland Court of Appeals, at page 26, approved the reasoning of Gibbons v. Mahon, supra, and adopted the following definition of a "dividend" from the Connecticut decision of Spooner v. Phillips, 62 Conn. 62, 24 Atl. 524, saying:

> *"The word 'dividend', if unqualified"*, said the Supreme Court of Errors of Connecticut, *"signifies dividends payable in money.* The word 'income' has a broader meaning, but hardly broad enough to include things not separated in some way from the principal." (Italics ours.)

It is to be observed that the North Carolina court in the Lancaster case, supra, cited the Maryland case of Smith v. Hooper as authority for holding that the expression "January dividends" did not include a stock dividend. The Maryland Court of Appeals has never questioned the correctness of its decision in the Smith case; on the contrary, this decision has been cited with approval on many occasions. See the following cases:

The Atlantic Coast Line Dividend Cases, 102 Md. 73, 61 Atl. 295;

Ex Parte Humbird, 114 Md. 628, 80 Atl. 209;

Hagerstown Trust Company, 119 Md. 224, 86 Atl. 982;

Washington County Hospital Association v. Hagerstown Trust Company, 124 Md. 1, 91 Atl. 724;

Krug v. Mercantile Trust & Deposit Co., 133 Md. 110, 104 Atl. 414.

The view that a stock dividend is in reality not a dividend at all but strictly a capital adjustment has been repeatedly affirmed in a long line of Federal decisions, commencing with Gibbons v. Mahon, supra. See also Towne v. Eisner, 245 U. S. 418, and Eisner v. Macomber, 252 U. S. 189. Since the question at issue is the effect of a reservation of dividends under a contract, it cannot be improper to look for guidance to these cases, because they turn upon the precise meaning of the word "dividend". In this respect, as will be shown, they differ from the Maryland trust apportionment cases under which stock dividends are awarded to the life tenant or remainderman, as the case may be, depending upon the source of the funds out of which the dividend is paid.

(4) Consideration of the rules governing the allocation of stock dividends between life tenant and remainderman in the administration of trusts.

At the time of the declaration of the stock dividend on October 31, 1930, the Maryland Court of Appeals had adopted what is known as the Pennsylvania Rule in the disposition of stock dividends in the administration of trusts. The theory of that rule is that the trustee should examine the source of every dividend, and once having ascertained this fact, it should pay over to the life tenant so much of the dividend as represents earnings which have accrued to the company paying the dividend during the period of the tenancy. Opposed to this is the Massachusetts or Federal rule that all stock dividends, regardless of their source, should be treated as corpus upon the theory that they are a part of the original stock, and cash dividends should be treated as income.

It is submitted that the majority of the Circuit Court of Appeals was correct in refusing to apply to the present

case the Maryland trust rule of apportionment of stock dividends. There are fundamental and important distinctions between a trust and a pledge and these distinctions may be briefly listed as follows:

FIRST. The problem as to the disposition of a stock dividend in the case of trusts is fundamentally one of internal trust administration and the so-called Pennsylvania Rule, adopted in Maryland, represents an effort to make an equitable adjustment between the conflicting interests of life tenant and remainderman. "The problem", as one text writer has put it, "is what disposition must be made of the new and old stock after the stock dividend in order that justice may be done to the two parties interested under the trust, the immediate beneficiary and his successor." Bogert on Trusts, Vol. 4, Sec. 847, p. 2454.

In the case of a pledge, the situation is essentially one of the construction of a contract. As already seen, the moment a pledge is made, the pledgee becomes entitled to all dividends, both cash and stock, by virtue of the pledge itself. If the pledgor intends to reserve either cash or stock dividends, he must of necessity prepare the contract so that both are included. Merely to reserve dividends does not include stock dividends for, as previously shown, a stock dividend is in reality not a true dividend.

SECOND: The problem in the case of life tenant and remainderman is to make an equitable distribution of property which, if given to one or the other, is forever disposed of. If the stock dividend is paid over to corpus, it is lost forever to the life tenant except for future income thereon, and if treated as income, the remainderman suffers an even greater loss for he loses the

dividend itself and fails to receive any interest upon it. Naturally, the courts have striven to remedy this injustice even at the sacrifice of legal considerations as to the true nature of a stock dividend.

A pledge, however, is simply security for an indebtedness. If the stock dividend is given to the pledgee, as is the case at common law in the absence of any reservation, it would eventually revert to the pledgor when the principal debt is paid. Thus the pledgor suffers no ultimate loss. If the principal debt is not paid, the pledgor has no right to the stock dividend.

THIRD: A further distinction of importance is the fact of a debtor-creditor relationship in the case of a pledge. One of the parties advances money to the other and takes certain property as security therefor. Until the principal debt is paid, it is proper that all dividends upon the pledged securities should go to the pledgee. Certainly this is true where the pledgor has an opportunity, as in this case, to reserve them, and fails to do so. There is no hardship to the pledgor for the pledgee must account for all profits and increment. Story on Bailments, Secs. 339 and 343; Fletcher on Corporations, Vol. 12, Sec. 5645. And the pledgor may retain, as was done in this case, the right to vote the stock, receive the cash dividends thereon, and exercise all other rights of ownership with respect thereto.

In the case of trusts, however, a situation is presented where neither the life tenant nor beneficiary has advanced any money and both, as a rule, are the beneficiaries of a gift from a third person whose purpose is to secure for the one an income for his life and for the other the principal of the fund upon the

death of the first. As a rule, neither has a hand in the preparation of the trust instrument. Under such circumstances, all equitable considerations are in favor of distributing the stock or extraordinary dividends, as the case may be, as equitably as possible. The Maryland Court of Appeals has given repeated recognition to this principle. In the first of the cases cited by the Receivers, Thomas v. Gregg, 78 Md. 545, 28 Atl. 565, after having determined to apportion the stock dividend in accordance with the Pennsylvania Rule, the Court said at page 560:

"We think this plan an equitable one."

And again at page 556:

"When it is possible for the court to ascertain whether the distribution in the stock dividends includes net earnings, and, if so, what proportion, and also whether such earnings were intended to be made a part of the capital or merely to be used temporarily with the intention on the part of the directors of refunding them to the shareholders as income, we think it is the duty of the court to make such investigations and dispose of the stock *in an equitable* way between the tenants for life and the remaindermen."

And in one of the latest Maryland cases upon this subject, Baldwin v. Baldwin, 159 Md. 175, 150 Atl. 282, the court reiterated the point expressed in the Gregg case to the effect that the controlling factor was an equitable adjustment of the conflicting interests between life tenant and remainderman. At page 181 of that report, the court said:

"The Pennsylvania Rule was adopted by this Court without qualification. It was chosen in preference to other rules which, while susceptible of more convenient application in the disposition of extraordinary dividends, were also capable of *causing injustice to the remainderman or to the life tenants.*"

In applying the Pennsylvania Rule, the Maryland court has never rested its decision upon the meaning of the word "dividend". In fact this is the differentiating factor between the Pennsylvania and the so-called Massachusetts Rule. In Maryland, the determining factor is the source of the funds out of which the dividend is paid. The Maryland court has frequently awarded a stock dividend to the remainderman despite the direction of the testator that all dividends should go to the life tenant.

FOURTH: A pledge involves more than the mere deposit of certain shares of stock; it may involve, as it did in the present case, the pledge of a very definite stock ownership interest in a corporation. The R-W Company stock has at all times been owned equally by six railway companies and when the 4,450 shares were pledged under the First Mortgage in 1901, the Trustee acquired by the pledge a one-sixth interest in that Company. To permit Seaboard to retain the stock dividend in question depreciates the value of the pledge because it automatically reduces the interest of the First Mortgage Trustee from a one-sixth interest to approximately a one-ninth interest. Even the loss of one share would be important in this case, as it would cause the Trustee to lose its position of parity with the five other competitive roads.

FIFTH: That it is improper to apply the trust rule in the case of a pledge can be demonstrated if we suppose a situation where the stock dividend is paid out of funds which have accumulated prior to the creation of the pledge. The Maryland trust apportionment rule would require an allocation of the stock dividend between the pledgor and pledgee. But this cannot be reconciled with a contract wherein it is stipulated that

> the pledgor shall have all dividends. It results in an unwarranted effort on the part of the court to remake and revise the contract. Clearly, either the stock dividend goes in its entirety to the pledgee under the common law or it goes in its entirety to the pledgor by virtue of the expressed reservation. There is no possible way to justify an in-between ground.

The Special Master fully appreciated this problem and his words were quoted with approval by the majority of the Circuit Court of Appeals. He said (R. 152):

> "But because a court would not adopt such a rule as this in order to protect a life tenant, it does not follow that it 'regarded a stock dividend as a real dividend' * * * especially when, as in the case of the Maryland court, it had expressly said that such a dividend was not a real dividend. And, because a court might think it would be just to give such a dividend to the life tenant rather than to the remainderman, in order to prevent the former from being prejudiced by the refusal of a corporation to declare cash dividends, it does not follow that it would consider it just to give it to a pledgor as against a pledgee, if, by so doing, it would *impair the principal of the pledgee's securities.*"

B. The Lien of the Receivers' Certificates Did Not Attach to Either the Stock or Cash Dividends.

In considering this question, it is worthwhile to observe that no question of local law is involved. As will be seen by a reference to the brief filed by the Receivers in support of their petition for certiorari, every case cited by them upon this subject is either a Federal or Supreme Court decision. The reason is plain. The basis of the controversy is simply the scope and effect of certain orders passed by the District Court upon their applications Nos. 19, 63 and 160 for the issuance of Receivers' Certificates (R. 87. See also R. 174 and 122.)

By their terms, these orders purported to create a first lien in favor of the holders of Receivers' Certificates upon the property of Seaboard "in the possession of or under the control of the Receivers" (R. 125). The Receivers now contend that because the stock dividend shares and the cash dividends were in their possession at the time these orders were passed, they became impressed with a lien irrespective of the fact that their possession may have been wrongful.

At the outset, it is essential to bear in mind that no contention has ever been made by the Receivers that the lien of the Receivers' Certificates extends to the pledged securities in the possession of any of the Mortgage Trustees. The Receivers, for example, have at all times conceded that the original 4,450 shares of R-W Company stock pledged with the First Mortgage Trustee are free of lien. It could not be contended otherwise, because the jurisdiction of the Receivers has never extended to securities in pledge under the various Mortgages. In the order appointing Receivers for the properties of Seaboard subject to the First Mortgage, entered by the District Court on May 29, 1931, it was expressly provided that the Receivers should,

> "be and they are hereby appointed * * * Receivers of all and singular the railroad, rolling stock, equipment, franchises, rights, interests, property and premises of every kind and description and wheresoever located belonging to the defendant, Seaboard Air Line Railway Company, and covered by and embraced in or under said First Mortgage (*other than the securities, and other property pledged to and now in the possession of the Complainant, The Continental Trust Company*) situate within the jurisdiction of this court, and of the totals, earnings, income, rents, issues and profits of the same and every part thereof, * * *". (Italics ours.)

An analysis of Receivers' application No. 19 (the same general pattern was followed in applications No. 63 and 160) reveals that no mention was made either in the petition itself or in the attached exhibits (R. 106 and 109) as to the fact that the 2,225 stock dividend shares were in the possession of the Receivers and were to be subject to the lien of the certificates. At the hearing upon this application, Exhibit 7 was introduced (R. 164) purporting to show a list of the free assets of Seaboard, and among the securities listed was the R-W Company stock dividend; but, as the Special Master has aptly pointed out in his very able and exhaustive discussion of this whole question, this exhibit was prepared from the Receivers' records and there was no finding by the court that it was correct. The only issues presented by the application were:

> FIRST, the necessity for the issuance of the Certificates, and
>
> SECOND, whether or not the security for the Certificates was to be all of Seaboard's assets, whatever those assets might be.

The Special Master's conclusion in this respect carries particularly weight because it was he who was appointed by the District Court to pass upon the issues of law and fact presented by the Receivers' original application to issue Certificates. Quoting from his opinion (R. 167):

> "The application did not contemplate that any question of title or of an existing lien, as between the Receivers, the First Mortgage Trustee, the Refunding Mortgage Trustees, or any other claimant, was to be passed upon. All that was contemplated was that the Court should decide that the issue of the certificates was necessary, and that they should be secured by all of the assets of the railway company, whatever these assets might be, and, to repeat, these were the only

> questions considered at the hearing before the Special Master, or after it by the court. It is apparent that neither the Special Master nor the court for a moment thought that they were deciding any issue as to title, or lien, or priority of claim. They were only deciding that the amount which the Receivers stated that they needed was in fact needed, and that, in order to borrow this amount, it was necessary that all the assets of the railway company should be pledged. But there was no issue raised, nor any decision made, as to whether any particular asset was in fact a free asset of the railway company."

The authorities fully sustain the Master's position.

> Cromwall v. County of Sac., 94 U. S. 351;
> New Orleans v. Citizens' Bank, 167 U. S. 371, 406;
> Baltimore S. S. Co. v. Phillips, 274 U. S. 316, 319;
> Radford v. Myers, 231 U. S. 725, 733;
> Oklahoma v. Texas, 272 U. S. 21, 41.

Furthermore, it is to be noted that the order entered by the District Court upon application No. 19 by its terms purports to subject only the property "of the Railway Company" to the lien of the Receivers' certificates (R. 125). For reasons which have been discussed, neither the stock nor the cash dividends can properly be regarded as the property of Seaboard so as to come within the scope of the language of the order. Seaboard was not simply under an obligation to turn over to the First Mortgage Trustee an amount of property equivalent to the stock and cash dividends in dispute. On the contrary, it is submitted that this specific property belonged to the Trustee. The cases clearly hold that where the pledgor receives the increment of pledge which is under a duty to turn over to a pledge, such increment is held by the pledgor in constructive trust. It cannot be considered as the property of the

pledgor. In the case of Peoples-Pittsburg Trust Co. v. Saupp, 320 Pa. 138, 182 Atl. 376, the court clearly held that the retention by the pledgor of a stock dividend upon pledged securities gave rise to an implied or constructive trust. See also Jones on Collateral Securities, 3rd Ed., Sec. 398.

CONCLUSION.

In conclusion, it is respectfully submitted that neither of the questions raised by the Receivers should be reviewed by this Court. Particularly is this true of the question pertaining to the lien of the Receivers' Certificates. If a review is granted, it should be limited to the first question which deals with the effect of the reservation of dividends under the First Mortgage.

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(24)

FILED
MAY 18 1942
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 1021.

LEGH R. POWELL, JR. and HENRY W. ANDERSON, as Receivers of the Properties of Seaboard Air Line Railway Company,

Petitioners,

against

MARYLAND TRUST COMPANY, as Successor Trustee under the First Mortgage of Seaboard Air Line Railway dated April 14, 1900,

Respondent.

PETITION FOR REHEARING OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

W. R. C. COCKE,
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IN THE

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MARYLAND TRUST COMPANY, as Successor Trustee under the First Mortgage of Seaboard Air Line Railway dated April 14, 1900,

Respondent.

PETITION FOR REHEARING OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Legh R. Powell, Jr. and Henry W. Anderson, as Receivers of the properties of Seaboard Air Line Railway Company, pray that a rehearing be had upon their petition for a writ of certiorari to review the decree of the United States Circuit Court of Appeals for the Fourth Circuit, filed herein on the 6th day of March, 1942, and denied on the 27th day of April, 1942.

A brief statement of the facts, the questions presented and the statute involved are contained in said petition and, in the interest of brevity, are not here repeated. As stated in said petition, the jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (C. 229, Stat.; 28 U. S. C., Sec. 347 (a)).

REASONS FOR GRANTING THE WRIT.

This case comes within the provisions of Paragraphs 5 (b) of Rule 38 of this Court.

In addition to the reasons set forth at pages 10 et seq. of the petition filed herein on March 6, 1942, viz.:

> "1. The Circuit Court of Appeals for the Fourth Circuit has here erroneously failed to apply the applicable Maryland law with respect to the nature of a stock dividend upon shares of capital stock of a corporation, a question of public importantance concerning the interrelation of State and Federal Courts, and has rendered a decision in conflict with the decisions of this Court.
>
> * * *
>
> "2. The Circuit Court of Appeals, as did the District Court, ignored the decrees directing the issuance of the Receivers' Certificates and providing for a lien security for such certificates, upon which decrees the holders of such certificates, for whom the Receivers are in a sense trustees, had a right to rely and in view of the record in the proceedings assume that the lien of the certificates covered the 2,225 shares of stock."

the decision of the Circuit Court of Appeals in this case is in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in the case of *Stentor Electric Mfg. Co., Inc.* v. *Klaxon Co.*, 125 F. (2d) 820, decided February 9, 1942, wherein it was held that where a question before a Federal Court is a matter of State law and there are no conclusive authorities among the State decisions upon the subject, the Court should ascertain the State law from all the available data.

The majority opinion of the Circuit Court of Appeals for the Fourth Circuit in this case refused to ascertain the Maryland law, clearly discernible from data before it stating that "To reason from analogy and apply the rule because of what we may guess the Maryland court would have decided if the case had been before it, is to indulge in vain speculation." Instead, the opinion undertook to apply its conception of general law derived from the decisions of courts other than those of Maryland. We endeavored to point this out clearly in our petition for certiorari and in the supporting brief.

A petition for a writ of certiorari to the Circuit Court of Appeals for the Third Circuit is being filed in the *Stentor Electric Mfg. Co.* case, *Supra*, and in order that there may be harmony among the rulings of the courts of the several circuits, it is respectfully submitted that the petition for a writ of certiorari filed in this case on March 6, 1942, should be granted.

The undersigned, counsel for Petitioners certify

that this petition is presented in good faith and not filed for the purpose of delay.

May 11, 1942.

W. R. C. Cocke,
Harold J. Gallagher,
Geo. V. Credle, Jr.,
For Petitioners.

(25)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 1021.

LEGH R. POWELL, JR., AND HENRY W. ANDERSON, AS RECEIVERS OF THE PROPERTIES OF SEABOARD AIR LINE RAILWAY COMPANY,

Petitioners,

against

MARYLAND TRUST COMPANY, AS SUCCESSOR TRUSTEE UNDER THE FIRST MORTGAGE OF SEABOARD AIR LINE RAILWAY DATED APRIL 14, 1900,

Respondent.

BRIEF ON BEHALF OF RESPONDENT IN OPPOSITION TO THE PETITION FOR REHEARING OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

THEODORE GARNETT,
EDWARD DUFFY,
CARLYLE BARTON,
WILLIAM A. GRAHAM,
Attorneys for Maryland Trust Company, Successor Trustee of Seaboard Air Line Railway First Mortgage, dated April 14, 1900.

May 21, 1942.

The Daily Record Co. Print, Baltimore.

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IN THE

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Petitioners,

against

MARYLAND TRUST COMPANY, AS SUCCESSOR TRUSTEE UNDER THE FIRST MORTGAGE OF SEABOARD AIR LINE RAILWAY DATED APRIL 14, 1900,

Respondent.

BRIEF ON BEHALF OF RESPONDENT IN OPPOSITION TO THE PETITION FOR REHEARING OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

PRELIMINARY STATEMENT.

On the 27th day of April, 1942, this Court denied the petition of Legh R. Powell, Jr. and Henry W. Anderson, as Receivers of the Properties of Seaboard Air Line Railway Company, for a writ of certiorari to review the decree of the United States Circuit Court of Appeals for the Fourth Circuit in this case. On May 18, 1942, the Receivers filed herein a petition praying that a rehear-

ing be had upon their original petition, alleging as grounds therefor a conflict between the decree of the United States Circuit Court of Appeals for the Fourth Circuit and the recent decision of the Circuit Court of Appeals for the Third Circuit in the case of Stentor Electric Mfg. Co., Inc. v. Klaxon Co., 125 Fed. (2d) 820. Believing the Receivers' assignment of grounds for a rehearing to be without merit, counsel for respondent, Maryland Trust Company, take this opportunity to file a short brief in opposition.

The jurisdiction of this Court to hear this cause, the opinions of the courts below and the facts of this case have been set forth in the respondent's brief filed in opposition to the Receivers' original petition and need not be repeated herein.

This Court is respectfully requested to treat this brief as an answer to the petition filed May 18, 1942 by the Refunding Mortgage Trustee for a rehearing of their original petition for a writ of certiorari to review the decree of the United States Circuit Court of Appeals for the Fourth Circuit in this case, this petition being filed in Case No. 1075 entitled: "New York Trust Co., Trustee, etc., vs. Maryland Trust Co., Trustee, etc." The issues raised in the two petitions for a rehearing are substantially the same and it is believed that the respondent's brief herein is an adequate answer to both.

ARGUMENT.

As stated, the sole ground assigned by the Receivers in justification of their petition for a rehearing of this matter is an alleged conflict between the decision of the United States Circuit Court of Appeals for the Fourth Circuit in the case at bar and the Klaxon Company case. The opin-

ion in that case was rendered on February 9, 1942 and was published in the Federal Reporter, under date of April 6, 1942. Three weeks elapsed between the publication of this decision and the order of this Court dated April 27, 1942, denying the Receiver's petition for a writ of certiorari, during which time the Receivers had ample opportunity to bring this decision to the attention of this Court. No reason is given for their failure to take this action and it hardly seems fitting that they should be permitted to do so now after this Court has entered its order denying their petition and after the mandate of the Circuit Court of Appeals for the Fourth Circuit has been handed down to the District Court for the Eastern District of Virginia.

Leaving aside the question of delay, however, and taking up the merits of the Receivers' petition, it is respectfully submitted that the alleged conflict between the two cases is without foundation. In the first place, the facts are entirely dissimilar. In the Klaxon Company case, after the remand of that case to the Circuit Court of Appeals for the Third Circuit, the sole question was whether under the conflict of laws rule prevailing in Delaware, reference was properly made to a New York statute providing for interest in actions for breach of contract. The suit was for damages for breach of a contract which was to be performed in the State of New York. Despite the assertion of counsel to the contrary, there was no Delaware decision squarely in point. Following the admonition of this Court in the case of West v. American Tel. & Tel. Co., 311 U. S. 223, 237, 61 S. Ct. 179, the Circuit Court of Appeals for the Third Circuit directed its efforts to ascertain the law of Delaware "from all the available data".

In the case at bar, while the facts are quite different from the Klaxon Company case, still the question before the

Circuit Court of Appeals for the Fourth Circuit was in one important respect the same, namely, the problem of ascertaining state law (here the law of Maryland) in the absence of a decision squarely in point. The question for determination was whether the Maryland Trust Company, as First Mortgage Trustee, was entitled to 2,225 shares of the Richmond-Washington Company stock declared as a stock dividend upon shares of stock held in pledge under the Mortgage, there being a reservation of "dividends" in favor of Seaboard Air Line Railway as pledgor. That there is no Maryland case precisely in point has been conceded at every stage of this controversy (R. pp. 145, 204, 221).

The majority of the court in the case at bar thereupon proceeded to ascertain the law of Maryland from all available data. As Judge Parker observed, had there been no reservation of dividends in favor of Seaboard Air Line Railway, the First Mortgage Trustee as pledgee would clearly have been entitled to all dividends. The case of Gemmell v. Davis, 75 Md. 546, 23 Atl. 1032, is a square decision in point. The Court of Appeals there said:

> "As between vendor and vendee of shares of stock it is the settled rule that the vendee is entitled to all the dividends on the stock which are declared after the sale of the stock. In other words, dividends belong to the person entitled to the stock when the dividends are declared. Abercrombie v. Riddle, 3 Md. Ch. 320. Even though the transfer has not been recorded, the transferee has a right to the dividends, as against the transferer. Cook on Stockholders, sec. 541. A pledgee is protected in the same way as a purchaser of stock, Ib., sec. 432, and consequently dividends declared during the continuance of the pledge belong to him, though he is not registered as owner on the corporate books. Cook, sec. 468; Hill v. Newichawanick Co., 71 N. Y. 593."

The cases make no distinction between stock and cash dividends. Both belong to the pledgee in the absence of a reservation to the contrary. This has been conceded by the Receivers. Furthermore, the Maryland Court of Appeals has unqualifiedly held that the word "dividends", if standing alone, means dividends payable in money. In Smith v. Hooper, 95 Md. 16, 51 Atl. 844, Chief Judge McSherry, speaking for the court, adopted the meaning given to the word "dividend" by the Court of Appeals of Connecticut in the case of Spooner v. Phillips, 62 Conn. 62, 24 Atl. 524. The Chief Judge said at page 26 of the Maryland report:

> " 'The word "dividend", if unqualified,' said the Supreme Court of Errors of Connecticut, 'signifies dividends payable in money. The word "income" has a broader meaning, but hardly broad enough to include things not separated in some way from the principal.' "

The rationale of these cases is clear. As Seaboard Air Line Railway reserved only "dividends" upon the pledged securities, the stock dividends in question, not being a dividend payable in money, must go under Maryland law to the Maryland Trust Company as pledgee.

While admitting that there is no precise Maryland decision in point, the Receivers complain that the majority should have applied the Maryland trust rule of apportionment. The answer is that the majority felt this rule to be entirely inapplicable to a pledge situation. In the case of a pledge there is a debtor-creditor relationship and the pledgor is entitled only to such cash or stock dividends as may have been expressly reserved under the contract of pledge. The issue thus turns upon the precise legal meaning of the word "dividends" as used in the reservation under the First Mortgage. The trust cases relied upon by the Receivers turn upon other principles and unmistakably show an effort on the part of the Maryland courts

to allocate stock dividends equitably between life tenant and remaindermen. These cases do not say what is or what is not a dividend and the Maryland Court of Appeals has recognized this fact. Speaking of these cases, two of which, Quinn v. Safe Deposit & Trust Co., 93 Md. 285, 48 Atl. 835, and Thomas v. Gregg, 78 Md. 545, 28 Atl. 565, are cited by the Receivers as their chief support, the Maryland Court of Appeals, in the case of Smith v. Hooper, supra, said at page 25:

> "It may not be out of place, before proceeding to solve that inquiry, to advert for a moment to several cases referred to in the argument. They are Quinn v. Safe Deposit and Trust Co., 93 Md. 285; Burt v. Gill, 89 Md. 152, and Thomas v. Gregg, 78 Md. 555. Those cases mainly determine, *not what is income or what are dividends*, but to whom income and dividends, confessedly such, belonged. *In the case at bar there is no dispute as to who is entitled to this increase if it be income or dividends, but the question is, does that increase constitute income or dividends at all? Obviously, therefore, the cases just referred to have no direct bearing upon this investigation.*" (Italics ours.)

Whether the majority was correct in rejecting the Maryland trust apportionment rule cannot be known until a Maryland court has passed upon the precise question. Their opinion, however, is fortified by the fact that both the District Court and the Special Master reached a similar conclusion. This is to be said for the opinion of the majority. Neither the dissenting Judge nor the Receivers can point to a single Maryland case which intimates, directly or indirectly, that the trust apportionment rule is applicable to a pledge situation. Indeed, the contrary is indicated in the quotation from Smith v. Hooper, supra. The reasons why the trust rule is applicable have been

summarized in the respondent's brief in answer to the Receivers' original petition, beginning at page 21. The point is moot in a sense because the Maryland Legislature in 1939 discarded the trust apportionment rule in favor of the Federal or Massachusetts rule. See Flack's Annotated Code of Maryland, Vol. II, Art. 75B. All stock dividends are now allocated in their entirety to the trust corpus. Clearly, therefore, if the issue in this case were to arise today, there would be no basis whatever for the Receivers' argument. It follows also that to inject the apportionment rule again into Maryland law can only lead to conflict and confusion.

To construe the case of Erie Railroad Company v. Tompkins, 304 U. S. 64, 82 L. Ed. 1188, as requiring a Federal court under the circumstances of this case to follow a rule of law which the court is convinced is inapplicable to the matter to be decided would result in a flagrant miscarriage of justice. The majority cannot be charged with failing to give full scope to the Maryland law. All the Receivers and the dissenting Judge can say is that they disagree with the conclusion reached by the majority, but that is hardly a matter for review by this Court. It certainly does not raise an issue under the Erie Railroad Company case.

Before concluding, it is pertinent to make one further observation. The majority rests its conclusion mainly upon the construction to be given to the reservation of dividends in favor of the Seaboard Air Line Railway Company under the First Mortgage. Judge Parker's opinion goes further, however, and indicates clearly that the court felt there were other grounds to support the conclusion reached, namely, the circumstances surrounding the execution of the Mortgage and the intention of the framers

of that instrument. It was said in the opinion of the majority:

> "We think the answer to this must be in the negative, *both because a contrary interpretation would be unreasonable in the light of surrounding circumstances,* and because, *even in the absence of such circumstances,* a stock dividend is not ordinarily included in the term 'dividends' as contained in a contract relating to dividends, in the absence of a clear indication that it was intended that they should be so included." (Italics ours.)

And further:

> "In the light of these authorities *as well as of the circumstances surrounding the transaction,* we think there can be no doubt but that the reservation of dividends on the stock pledged should be construed not to include the stock dividends, * * *" (Italics ours.)

Among the circumstances reflecting an intent that the First Mortgage Trustee should have all stock dividends is the fact that any other conclusion would materially depreciate the value of the pledge. To award the 50% stock dividend to the Receivers of Seaboard Air Line Railway Company lessens the pledge from a one-sixth interest in favor of the Trustee to a one-ninth interest, thus dislodging the Trustee's position of parity with the five other competing railway companies owning all of the capital stock of the Richmond-Washington Company. As the majority properly concluded, the First Mortgage shows a clear intention to preserve, not to impair, the interest of the pledgee in the pledged securities. It is hardly to be supposed, therefore, that the Railway Company was intended to have a stock dividend in the absence of a clear provision to this effect, certainly not a stock dividend of the size and character of the one in question. The proper construction

of the First Mortgage in this respect presents a problem of first impression and, while theoretically a question of local law, must be answered in the final analysis by the court before whom the issue arises. No Maryland decisions are of any particular help. It is, therefore, submitted that the majority's conclusion upon this aspect of the case should not be disturbed in the absence of compelling reasons.

Whatever view may be taken with respect to the Klaxon Company case, certainly that decision presents no reasons justifying a review of the second of the questions raised by the Receivers pertaining to the scope and effect of the lien in favor of the holders of the Receivers' Certificates. As observed in the original brief filed on behalf of the respondent, the answer to that question depends wholly upon a consideration of the Receivers' applications Nos. 19, 63 and 160 for the issuance of Receivers' Certificates (R. 87, also 174 and 122) and the orders of the District Court entered thereon. In view of this fact and the further fact that Judge Soper's dissenting opinion does not question the soundness of the majority's conclusion, it is submitted that the Receivers' request for a review of this issue should be denied.

CONCLUSION.

In conclusion, respondent respectfully submits that the Receivers have failed to present any grounds justifying a review of either of the questions presented in their petition for a rehearing of their original petition for a writ of certiorari. Particularly is this true of the question pertaining to the lien of the Receivers' Certificates. If the review is granted, it should be limited to the first question raised in their petition which deals with the effect under

Maryland law of the reservation of dividends in favor of Seaboard Air Line Railway Company under the First Mortgage.

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May 21, 1942.